M E M O R A N D U M

November 2, 2007

TO: Councilmembers

FROM: Robert H. Drummer, Legislative Attorney

SUBJECT: Divestment of certain companies doing business in Sudan

The crisis in Sudan was outlined in a recent article in the Washington Post with a chronology of events at ©A and an article at ©1.

In response to a request from Councilmembers and the Executive, the Board of Investment Trustees (Board) reviewed the issue of divestment of certain companies doing business in Sudan. A copy of the Board's response is attached at ©7. The Board, after consultation with the County Attorney's Office, concluded that its current authority does not permit it to consider non-economic criteria in its investment decisions. The Board also listed a series of problems it believes use of non-economic criteria would create. This memorandum addresses the major issues involved in this area and the options for Council action.

Background

The Board was established by County Code §33-59 for the purpose of managing the Trust Fund assets of the three County retirement plans: the Employees' Retirement System (ERS), the Retirement Savings Plan (RSP), and the Deferred Compensation Plan (DCP). There are some important distinctions among the plans. The ERS is a defined benefit plan for public safety employees, and for non-public safety employees hired before October 1, 1994. The Trust Fund includes contributions from both the County and employees as well as investment earnings from those contributions. In FY07, the County contributed $109 million and employees contributed $16 million. Participants in this plan receive a pension at retirement based upon their salary and their years of service. The RSP is a defined contribution plan covering non-public safety employees hired on or after October 1, 1994. The RSP also includes contributions from both the County and employees. In FY07, the County contributed $11 million and employees contributed $7 million. Participants in the RSP have a choice of investment funds selected by the Board or may select other funds through the Self Directed Brokerage Window, and they receive retirement income based upon the value of their individual account. The DCP includes only employee contributions and also provides a choice of investment funds selected by the Board, or employees may select other funds through the Self Directed Brokerage Window.

Section 33-60 requires the Board to retain investment managers to select individual stocks, bonds, and other securities for the ERS Trust Fund. Section 33-61C sets forth the following standard of care for the Board in exercising its fiduciary duties:

> A fiduciary must discharge the fiduciary's duties regarding the retirement systems:
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> (a) only in the best interest of the participants and their beneficiaries;
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> (b) only to provide benefits to the participants and their beneficiaries, and defray reasonable expenses of administering the retirement systems;
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> (c) with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes;
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> (d) by diversifying the investments of the retirement systems to minimize the risk of large losses, unless it is clearly not prudent to diversify under the circumstances;
>
> (e) according to a good faith interpretation of the law governing the retirement systems;
>
> (f) according to a good faith interpretation of the documents and instruments governing the retirement systems, if they comply with this Article.

This statutory standard of care is derived from the fiduciary duties of loyalty and prudence mandated for private retirement plans by the Federal Employee Retirement Income Security Act (ERISA).

Summary of the Law

The landmark case in Maryland concerning the fiduciary duty of a trustee for a public retirement plan is *Board of Trustees v. Mayor & City Council of Baltimore City,* 317 Md. 72 (1989). The Maryland Court of Appeals upheld a city ordinance requiring the city pension systems to divest all holdings of companies doing business in South Africa in order to protest the government-sponsored apartheid system in South Africa. The trustees argued that the legislation was both an unlawful delegation of legislative power to private persons and an unconstitutional impairment of contracts. Although the ordinance required the trustees to determine which companies were doing business in

South Africa by reference to a changing list adopted by a private organization, the Court rejected the unlawful delegation argument by holding that the ordinance permitted the trustees to determine for themselves which companies were doing business in South Africa. The Court rejected the impairment of contracts argument based upon a factual finding of the trial court that the ongoing cost of compliance to the beneficiaries would be approximately 1/20 of 1% of their assets on a continuing basis. The Court held that this cost did not significantly alter the duty of prudence that was part of the pension contract with the employees because it was *de minimis.* Any legislation requiring the Board to divest holdings of companies doing business in Sudan would have to meet this undefined *de minimis* standard established by the Court of Appeals in *Mayor & City Council of Council of Baltimore City.*[1]

State and local laws requiring the divestment of holdings in companies doing business in Sudan or other nations have recently been challenged in court on additional grounds. The Supreme Court struck down a Massachusetts statute that required the state to boycott certain companies doing business with or in Burma in *Crosby v. National Foreign Trade Council*, 530 US 363 (2000). The Supreme Court struck down the state law, holding that it was preempted by federal statutes imposing sanctions on Burma and therefore violated the Supremacy Clause of the U.S. Constitution. Earlier this year, the U.S. District Court in Illinois issued an injunction against the Illinois Sudan Act in *National Foreign Trade Council v. Giannoulias,* Case No. 06 C 4251, 2007 U.S. Dist. LEXIS 13341 (Feb. 23, 2007). The Illinois statute in question prohibited the state from depositing funds in any financial institution that could not certify that it did not loan money to the government of Sudan or certain companies doing business in Sudan and also prohibited state and local pension funds from investing in certain companies doing business in Sudan. The Court held that this statute violated the Supremacy Clause and the Foreign Commerce Clause of the U.S. Constitution.

Despite these potential legal issues, the Sudan Divestment Task Force reports that 20 states and 10 local governments have recently enacted laws aimed at preventing investments by public retirement plans in certain companies doing business in Sudan. The Sudan Divestment Task Force is an organization that promotes the campaign to encourage asset managers to divest holdings in certain companies doing business in Sudan. See the Task Force Information Sheet at ©10.

The Maryland General Assembly enacted the 2007 Darfur Protection Act effective July 1, 2007 (codified at State Personnel & Pensions Art. §21-123.1) covering the State retirement systems. See ©11. This statute requires the State retirement system Board of Trustees to determine which companies that were held in the portfolio on July 1, 2007 are conducting business in Sudan and make divestment decisions based upon a list of factors set forth in the statute. The statute also prohibits any new investments in certain companies doing business in Sudan. The Board is also required to encourage the targeted

[1] Bill 23-86 created the ERS Trust Fund and the Board of Trustees in 1986 and also included a prohibition against investments in companies doing business in South Africa and Namibia. This divestment provision was repealed after the end of the apartheid system in 1993.

companies to change their business practices and notify them in writing of any decision to divest holdings of that company if it fails to make the requested changes. The State Retirement and Pension System of Maryland recently released a report describing their experience with this new law. The Board reported that it retained a consultant, Institutional Shareholder Services, to provide a monthly list of companies doing business in Sudan. The consultant identified 41 companies, 7 of which were owned in the trust fund. As of June 30, 2007, the Board had instructed its managers to avoid making new investments in any of the 41 companies identified by the consultant, as the statute requires, but had not yet divested any of the 7 companies already held. A copy of the report is attached at ©18.

Issues

1. What is the cost of divestment to the Trust Funds and the County?

There are two components to costs associated with divestment. First, there is the cost of administering the program. The Sudan Divestment Task Force recommends a targeted divestment approach that begins by notifying in writing all of the companies on their list of the worst offending companies of intent to divest unless they take concrete actions to change their business practices in Sudan. The Task Force recommends divestment only if the targeted company fails to change its business practices in Sudan after a certain period of time. The Task Force compiles an ongoing list of companies that they believe deserve scrutiny. There are 23 companies on the current Task Force list of "highest offenders." See ©50.

Unfortunately, there is no standard methodology for determining which companies should be on the list of offending companies, and different organizations have different lists. The ISS, on behalf of the Maryland Board of Trustees, identified 41 such companies. A copy of this list is attached at ©55. The task of a board implementing a Sudan divestment law is further complicated under the Task Force model since the board must analyze and judge the company's progress in changing its business practices before deciding whether to divest holdings or prohibit future investment in that company.

The second component is the potential loss of investment returns. It is impossible to predict future returns from any investment portfolio, but there is some evidence that past returns for a "Sudan free" portfolio are lower than its benchmark index. KLD Research & Analytics, Inc. (KLD) is a private company that operates a fee-based research and investment service that tracks companies to avoid in a targeted divestment approach recommended by the Sudan Divestment Task Force. KLD also tracks the returns of a large cap Sudan Free Social Index of equities against the Russell 1000 equity index. According to KLD, the investment returns for the Sudan free index have lagged behind the Russell 1000 since January 1, 2007 (9.30% against 7.85%). See ©25. Wilshire Consulting has tracked a Sudan free portfolio against a benchmark index over the past 5 years and reports a lower return of the Sudan free portfolio for different types of equities ranging from 0 .1% to 0 .42%. See ©26.

Another undefined cost of divestment is the transaction cost for selling assets before the investment manager would normally do so. Finally, certain successful investment managers may decline to accept the County's business with these restrictions or raise the fees they charge for actively managed funds to cover the cost of compliance. Some of the Board's managers have indicated reluctance or inability to work with this type of restriction. Warren Buffet has recently rejected requests from Sudan divestment proponents to divest a $3.3 billion position in PetroChina Co. held by Berkshire Hathaway, Inc. See ©27.

2. **Who should pay for the costs of divestment?**

The ERS is a defined benefit plan. If the cost of divestment reduces the value of the Trust Fund, the County remains obligated to pay the participants the same pension earned based upon the plan document. Therefore, the cost of divestment would fall to the County taxpayers. The Trust Fund currently has an unfunded liability of $700 million. The Board estimates that a 0.1% decrease in the ERS' investment return equates to an annual estimated increase of $2.7 million in the required County contribution.

Both the RSP and the DCP create separate accounts for individual employees. The Board is responsible for selecting the investment fund options available for employees, but the employees are responsible for selecting their own investment funds from the options given. Therefore, if a Sudan free requirement either reduces the return of an investment fund selected by employees or eliminates a successful investment fund that employees would select, then the cost of divestment falls on the employee. For example, divestment advocates have criticized popular Fidelity funds, currently available to employees, that hold shares of PetroChina Co., including Contrafund and some Fidelity international funds. As noted above, both the RSP and the DCP also have a Self Directed Brokerage Window that permits employees to choose any of more than 9,000 mutual funds beyond the options selected by the Board, including many funds that practice different forms of social investing. This brokerage window may need to be closed or at least significantly reduced if the RSP and the DCP are included in a Sudan divestment law.

3. **Where does the Council draw the line for social investing?**

Social investing occurs when an investment manager applies non-economic criteria to the standard financial analysis of individual investment alternatives in order to promote a social, environmental, or political objective. Legislation requiring the divestment of holdings in certain companies doing business in Sudan is an example of social investing. Trustees for private sector retirement plans are generally prohibited from making investment decisions based upon non-economic criteria due to the Department of Labor's interpretation of the fiduciary rules established by ERISA. See Advisory Opinion dated May 28, 1998 at ©29. Since these statutory provisions of

ERISA do not apply to government retirement plans, some state and local governments have moved into this arena.

Social investing goes far beyond foreign policy issues. The July-August 2003 Issue of *Harvard Magazine* reported that the University has a standing student-faculty Advisory Committee on Shareholder Responsibility to advise its investment committee as to how to vote on shareholder proxy initiatives for stocks that the University owns. This Committee screened 108 shareholder proposals in 2003 raising such topics as genetically engineered food, nuclear power, secondhand smoke in restaurants, and the availability of drugs to treat disease in Africa. The Committee also delves into issues involving corporate governance.

The Maryland Save Darfur Act contains a preamble that sets forth a position that divestment of public funds from certain companies should be limited to instances of genocide, such as the horrors of Darfur. Yet, legislation is expected to be introduced in the General Assembly in the next session to extend divestment to certain companies doing business in Iran, North Korea, and Syria.[2] There are also advocacy groups for divestment of public pension funds in companies doing business in other countries. A casual search of the internet yielded websites devoted to divestment of companies doing business in Iran, Burma, Syria, North Korea, Saudi Arabia, and Israel.

Legislation to require the divestment of public pension funds in certain companies doing business in Sudan would raise the issue of doing the same for other countries. As the list of companies that are on the prohibited investment list grows, the potential costs of divestment also grow. This can increase the likelihood that these costs exceed the *de minimis* test established by the Maryland Court of Appeals in *Board of Trustees v. Mayor & City Council of Baltimore City* and consequently increases the likelihood that the legislation could be enjoined.

4. **Should divestment legislation include commingled fund investments?**

The Maryland Save Darfur Act expressly excludes "indexed funds, private equity funds, real estate funds, or other commingled or passively managed funds" from the eligible accounts that must divest certain companies doing business in Sudan. This appears to be a common provision in other similar laws. An investor in such a commingled fund has no ability to dictate divestment to the fund manager, and therefore can only divest by selling the fund itself. If the Council decides to enact legislation requiring the divestment of holdings in certain companies doing business in Sudan, Council staff would recommend that this type of exclusion be included.

5. **Is divestment legislation effective?**

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[2] California recently enacted a law requiring divestment by public pension funds from companies doing business in Iran.

There are at least two schools of thought on this issue. The Sudan Divestment Task Force argues that the government of Sudan has historically been vulnerable to targeted economic pressure. They point to a campaign established by the government of Sudan challenging the divestment movement, including a $1 million advertisement in the New York Times. The Task Force also argues that the share prices of companies targeted by the divestment movement should go down in the future. See Task Force Fact Sheet at ©32.

Opponents of social investing argue that the share price of a company is controlled by the market. A drop in price due to divestment by large fund managers will create a temporary profitable trading opportunity that market participants will exploit and force the price back up. Opponents also argue that divestment leads to less diversification and thereby adversely affects investment returns in the long run. They also point out that boards of trustees are ill equipped to make the complicated determinations as to which businesses to avoid that are necessary to implement divestment statutes. See Alicia H. Munnell, *Should Public Plans Engage in Social Investing?* Center for Retirement Research at Boston College, August 2007, attached at ©34.

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An Evolving Policy on Darfur

2003

Feb. 26 A Darfur rebel group attacks a government police station, an incident widely described as the beginning of a rebellion that eventually will lead to a major humanitarian disaster. By U.N. calculations, more than 2 million people will be made homeless and more than 200,000 people will die.

2004

Sept. 9 Appearing before the Senate Foreign Relations Committee, Secretary of State **Colin L. Powell** becomes the first U.S. official to describe the killings in Darfur as genocide.

"We concluded — I concluded — that genocide has been committed in Darfur and that the government of Sudan and the Janjaweed bear responsibility — and genocide may still be occurring," Powell says.

2005

Jan. 31 A U.N. commission investigating atrocities in Sudan concludes that the government did not pursue a policy of genocide in the Darfur region but that Khartoum and government-sponsored Arab militias known as Janjaweed engaged in "widespread and systematic" abuse that may constitute crimes against humanity. The commission recommends that the International Criminal Court pursue war crimes prosecutions.

July 20 Visiting Sudan, Secretary of State **Condoleezza Rice** defends the administration's policy on Darfur, saying U.S. actions helped "avert some of the humanitarian disaster that was foreseen" a year earlier.

2006

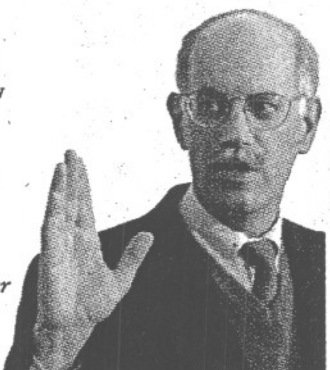
Feb. 17 **President Bush** calls the NATO secretary general to urge the alliance to play a greater role in Darfur and later tells a Florida audience of his plans.

"It's going to require . . . a NATO stewardship, planning, facilitating, organizing, probably double the number of peacekeepers that are there now, in order to start bringing some sense of security," Bush says. "There has to be a consequence for people abusing their fellow citizens."

May 5 The Darfur Peace Agreement is brokered by Deputy Secretary of State **Robert B. Zoellick** between the government of Sudan and the largest rebel group. But other rebel groups refuse to participate, and fighting eventually resumes.

Sept. 19 In a speech to the United Nations, **Bush** names former USAID administrator **Andrew S. Natsios** (at right) to be special envoy to Sudan with a mandate to help resolve the dispute in Darfur, and warns that Khartoum is obstructing an international force.

"If the Sudanese government does not approve this peacekeeping force quickly, the United Nations must act," Bush says. "Your lives and the credibility of the United Nations is at stake."



2007

May 29 **Bush** imposes new sanctions on Sudanese companies to try to pressure Khartoum to accept international peacekeepers in Darfur.

"For too long, the people of Darfur have suffered at the hands of a government that is complicit in the bombing, murder and rape of innocent civilians," Bush says.

BY MIKE ABRAMOWITZ AND SETH HAMBLIN — THE WASHINGTON POST

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washingtonpost.com

U.S. Promises on Darfur Don't Match Actions

Bush Expresses Passion for Issue, but Policies Have Been Inconsistent

By Michael Abramowitz
Washington Post Staff Writer
Monday, October 29, 2007; A01

In April 2006, a small group of Darfur activists -- including evangelical Christians, the representative of a Jewish group and a former Sudanese slave -- was ushered into the Roosevelt Room at the White House for a private meeting with President Bush. It was the eve of a major rally on the National Mall, and the president spent more than an hour holding forth, displaying a kind of passion that has led some in the White House to dub him the "Sudan desk officer."

Bush insisted there must be consequences for rape and murder, and he called for international troops on the ground to protect innocent Darfuris, according to contemporaneous notes by one of those present. He spoke of "bringing justice" to the Janjaweed, the Arab militias that have participated in atrocities that the president has repeatedly described as nothing less than "genocide."

"He had an understanding of the issue that went beyond simply responding to a briefing that had been given," said David Rubenstein, a participant who was then executive director of the Save Darfur Coalition, which has been sharply critical of the administration's response to the crisis. "He knew more facts than I expected him to know, and he had a broader political perspective than I expected him to have."

Yet a year and a half later, the situation on the ground in Darfur is little changed: More than 2 million displaced Darfuris, including hundreds of thousands in camps, have been unable to return to their homes. The perpetrators of the worst atrocities remain unpunished. Despite a renewed U.N. push, the international peacekeeping troops that Bush has long been seeking have yet to materialize.

Just this weekend, peace talks in Libya aimed at ending the four-year conflict appeared to be foundering because of a boycott by key rebel groups.

Many of those who have tracked the conflict over the years, including some in his own administration, say Bush has not matched his words with action, allowing initiatives to drop because of inertia or failure to follow up, while proving unable to mobilize either his bureaucracy or the international community.

The president who famously promised not to allow another Rwanda-style mass murder on his watch has never fully chosen between those inside his government advocating more pressure on Sudan and those advocating engagement with its Islamist government, so the policy has veered from one approach to another.

Meanwhile, a constant turnover of key administration advisers on Darfur, such as former deputy secretary of state Robert B. Zoellick and presidential aide Michael Gerson, has made it hard for the administration to maintain focus.

"Bush probably does want something done, but the lack of hands-on follow-up from this White House allowed this to drift," said one former State Department official involved in Darfur who did not want to be quoted by name criticizing the president. "If he says, 'There is not going to be genocide on my watch,' and then 2 1/2 years later we are just getting tough action, what gives? He has made statements, but his administration has not given meaning to those statements."

Since the United States became the first and only government to call the killing in Darfur genocide, Bush and his aides have grappled with how to provide security for civilians in a large, remote area in the heart of Africa.

While almost everyone involved in Darfur policy agrees that an African Union peacekeeping force of just 7,000 troops is not up to the task, the United States has refused to send troops and, despite promises of reinforcements, has yet to secure many additional troops from other countries. At the same time, it has been unable to broker a diplomatic resolution that might ease the violence.

Even Bush has complained privately that his hands are tied on Darfur because, with the U.S. involvement in Iraq and Afghanistan, he cannot be seen as "invading another Muslim country," according to people who have spoken with him about the issue.

"It's impossible to keep Iraq out of this picture," said Edward Mortimer, who served as a top aide to then-U.N. Secretary General Kofi Annan and says resentment over Iraq caused many countries to not want to cooperate with the United States on Darfur.

Bush advisers argue that the lack of success reflects the limitations of working through institutions such as the United Nations, NATO and the African Union. They cite the billions of dollars of U.S. relief aid that has kept millions of Sudanese alive. They say U.S. pressure has kept the issue on the world's agenda.

"If there was ever a case study where the president sees the limitations and frustrations of the multilateral organizations, it is the issue of Darfur," said Dan Bartlett, former White House counselor. "Everybody for the most part can come to a consensus: Whether you call it genocide or not, we have an urgent security and humanitarian crisis on our hands. Yet these institutions cannot garner the will or ability to come together to save people."

There is no doubt that responsibility for inaction on Darfur can be spread around. The Sudanese government has resisted cooperation at every step in the saga and has been shielded at the United Nations by China, its main international protector. Few other Western nations, with the notable exception of Britain and some Nordic countries, have shown much interest in resolving the crisis. The process of raising peacekeepers from U.N. members has proved tortuously slow.

"There's an enormous stain on the world's conscience," said Mitchell B. Reiss, former State Department policy planning chief. "We collectively stood by and let it happen a decade after it happened in Rwanda."

A President's Passion

In late 2005, Bush gathered his most senior advisers to discuss what to do about Darfur. He wanted to know whether the U.S. military could send in helicopter gunships to attack the militias if they launched new attacks on the refugee camps. Could they also shoot down Sudanese military aircraft if necessary? he asked. His aides worried that the United States could get involved in another shooting war, and the president backed off.

"He wanted militant action, and people had to restrain him," said one senior official familiar with the episode. "He wanted to go in and kill the Janjaweed."

The meeting underscored both Bush's personal investment in Sudan, dating back to the beginning of his administration, and his instinct, which aides have kept in check, to take direct action.

Many close to Bush believe that this intense interest in the issue was heavily influenced by American evangelicals, who have adopted the cause of Christians in southern Sudan. Even before the crisis in Darfur, in western Sudan, one of Bush's foreign policy goals was to try to end the civil war between the Muslim government in Khartoum and rebels in the south, a conflict that had lasted more than two decades and cost more than 2 million lives.

Former senator John C. Danforth (R-Mo.), whom Bush appointed as his special envoy for Sudan, said the president's interest in the country is rooted in a larger sense of morality. "This isn't a country that has much strategic interest for the United States," he observed.

Bush's initiative to broker a north-south deal worked. Despite difficult negotiations, Sudanese President Omar Hassan al-Bashir agreed in January 2005 to a plan to share power and oil revenues with the rebels -- and even gave the south the right to secede in six years if the leadership could not reconcile their differences.

But by then a separate conflict had exploded in Darfur, as long-standing conflicts between African farmers and Arab herders over land, and a failure by the Khartoum government to redress local grievances, boiled over into armed rebellion.

The government turned to a tactic it had employed in fighting the southern rebels: arming local Arab militias, the Janjaweed, to carry out a counterinsurgency on its behalf. The militias rampaged throughout Darfur starting in mid-2003, burning hundreds of villages, raping women and summarily executing African villagers, according to numerous human rights reports. More than 200,000 people have died in Darfur since the crisis erupted, according to U.N. estimates. Some estimates place the figure as high as 450,000.

Many familiar with Sudan believe that Bush and his aides initially averted their gaze to the flaring violence in Darfur because raising the issue might interfere with the difficult negotiations with Bashir. Some U.S. officials saw another reason for the reluctance to get involved: preserving a burgeoning intelligence relationship with Khartoum, which had begun sharing critical information about al-Qaeda and other Islamic extremists.

"There was a tendency not to see Darfur initially for what it was," said Gerard Gallucci, who served in 2003 and 2004 as the top U.S. diplomat in Khartoum. It was well known among Western governments, he said, that Sudan "was using terror to cleanse black Muslim Africans from land that they had promised the Janjaweed."

Such claims are vigorously contested by Danforth and other Bush advisers, who say the president

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repeatedly warned Bashir about the consequences of sending Arab militias after defenseless civilians.

Over time, Bush has become increasingly outspoken about the situation in Darfur, raising the issue with foreign leaders and meeting privately with dissidents and other little-known political players in Sudan to encourage a solution. In recent months, he has singled out Bashir for harsh condemnation, accusing him of subverting efforts to bring peace to Darfur.

Meeting with the Darfur activists, Bush acknowledged that Sudan had cooperated in anti-terrorism initiatives -- but he insisted that Khartoum could not "buy off" the United States, Rubenstein said.

Last spring, when the White House worked on a new plan to try to press Sudan's government to accept international peacekeepers, it was the president himself who was the driving force in the interagency process, many officials involved the debate said. According to national security adviser Stephen J. Hadley, Bush refused to accept a program developed to confront Sudan because he was concerned that it was not tough enough. He kicked it back to the bureaucracy.

"I've had it with this incrementalism," Hadley quoted the president as saying in the Oval Office. "We're going to lead, and if people don't want to follow us, they're going to have to stand up and explain why they are willing to let women continue to be raped in Darfur."

At one point, one senior official said, Bush wanted action to crimp Sudan's booming oil business, a move that would have severely aggravated relations with China -- and that no one else in the government favored.

There was stunned silence in the room, the official said, when Hadley disclosed Bush's idea to other government officials. Hadley made clear he was not interested in having a discussion, but the administration never went as far as the president seemed to be demanding. Instead, Treasury officials came up with a sanctions plan aimed at tracking and squeezing key individuals and companies in the Sudanese economy, including the oil business.

Wary of Sending Troops

At an appearance in Tennessee this summer, Bush raised a question many have asked about the situation in Darfur: "If there is a problem, why don't you just go take care of it?" But Bush said he considered -- and decided against -- sending U.S. troops unilaterally. "It just wasn't the right decision," he said.

With the United States tied down in Iraq and Afghanistan, skepticism about using U.S. soldiers, even in a limited way, cut across agencies and bodies that often disagree, from the State Department to the Pentagon to Vice President Cheney's office, according to many current and former officials.

Advisers say Bush came to accept, albeit grudgingly, the arguments against using U.S. military assets -- especially the possibility that they might attract al-Qaeda. "In my mind, there would never be enough troops to impose order on this place," former secretary of state Colin L. Powell said an interview. "The only way to resolve this problem was for there to be a political settlement between the rebels and the government."

Sharing this belief was Powell's bureaucratic nemesis, then-Defense Secretary Donald H. Rumsfeld, who advocated sending troops to Iraq but not to the middle of Africa, according to many officials in the government.

This aversion to any use of force was frustrating to some lower-ranking government officials, who saw a modest U.S. military effort as indispensable to making the Sudanese take American diplomacy seriously. Early in the crisis, in the summer of 2004, the U.S. mission in Khartoum made clear to Washington its belief that the African Union was incapable of dealing with the security problem in Darfur on its own.

It recommended that several hundred U.S. troops help fly in African Union forces and provide other assistance, according to a former State Department official. The idea was never seriously entertained, the official said, and it was not until two years later that the United States began making efforts at the United Nations to bolster the overmatched African mission.

Roger Winter, a former State Department official who was intimately involved with Sudan policy during the Bush administration, argues that the United States has never been serious about pressuring the Sudanese government. "They know what we will do and what we won't do," he said. "And they don't respond unless there is a credible threat. And they haven't viewed everything that has happened up until now as credible."

Carrots vs. Sticks

Over the course of the conflict, Bush has found himself torn between different factions in his administration over how to handle Sudan -- whether, simply put, to try carrots or sticks.

In early 2006, Bush empowered Zoellick to seek a peace deal between Khartoum and the Darfur rebel groups. Zoellick, now president of the World Bank, was essentially pursuing what one senior U.S. official described as a policy of engagement with the Sudanese government, even though the Bush administration believed it was involved in perpetrating the atrocities in Darfur.

Zoellick worked closely with senior Sudanese officials and dangled the possibility of improved relations and other incentives should Khartoum cooperate in bringing peace to Darfur. And he came close to pulling it off: An agreement to end the violence was negotiated in the spring of 2006, but it fell apart after key rebel leaders refused to sign on.

Some U.S. officials say Bush never completely bought into Zoellick's approach. He seems to have been influenced in that regard by Gerson, the then-speechwriter who was given a wide-ranging policy berth in the early part of Bush's second term.

Gerson, now a Washington Post columnist, is a devout Christian who was especially animated by the part of the Bush agenda that focused on alleviating suffering in Africa. He traveled to Sudan with Zoellick in late 2005, a trip that included a meeting with Bashir, and came back convinced that Khartoum was not seriously interested in efforts to improve conditions in Darfur.

"There was always a series of incremental steps, and nothing changed on the ground," Gerson said later.

Returning to Washington, Gerson told Bush that Bashir was feeling no pressure to cooperate and that the African Union peacekeepers were not up to the task of protecting civilians. He also suggested that it might be useful to establish a no-fly zone to prevent the Sudanese government from flying bombing missions in support of Janjaweed attacks.

Several months later, Gerson sent Bush some articles criticizing the U.S. approach as anemic, and Bush summoned his aide to the Oval Office, a little hot under the collar because he did not agree with the criticism. But he assured Gerson, as the former aide remembers, "I want you to know we are acting on this."

In February 2006, Bush proposed using NATO forces to help quickly bolster the beleaguered African Union mission. The president seemed so excited about the idea that he mentioned it, almost casually, in response to a question about Uganda during a public appearance in Florida. The statement stunned some in the U.S. bureaucracy.

But even Bush's efforts to promote the idea did little to move the process along. The French were leery of a new NATO mission outside its normal sphere of operations, and there was no interest from Sudan or the African Union in a major role for this quintessentially Western military alliance, according to U.S. officials. The plan went nowhere.

Now, 20 months later, with Zoellick and Gerson gone, new administration figures are working with other countries on new plans for peace and peacekeepers in Darfur. Given the track record, those who have handled Darfur over the years are cautious.

"Overall," concluded John R. Bolton, the former U.S. ambassador to the United Nations, "Sudan is a case where there's a lot of international rhetoric and no stomach for real action."

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To: Isiah Leggett, County Executive
Marilyn Praisner, Council President

Re: Divestment from Sudan

The Board of Investment Trustees met on October 19, 2007 to discuss the issue of divestment from certain companies doing business in Sudan, which your offices have asked us to review.

As individuals, members of this Board share the revulsion felt worldwide about the genocide in Darfur conducted by the current government of Sudan. As a Board, we are limited by our investment authority, which comes from the Montgomery County Code. Sections 33-60, 33-125, and 33-145 grant the Board the authority to invest and manage the Trust Fund assets of the County's three retirement plans, the Employees' Retirement System (ERS), Retirement Savings Plan (RSP), and Deferred Compensation Plan (DCP).

Fund assets in the ERS and RSP come from both employees and County taxpayers. Assets in the DCP come solely from employees.

Section 33-60 requires the Board to retain investment managers to choose individual securities, including stocks and bonds. The Board itself cannot select individual securities.

Section 33-61C provides that "a fiduciary must discharge the fiduciary's duties regarding the retirement systems:

- only in the best interest of the participants and their beneficiaries; *[Duty of Loyalty]*
- only to provide benefits to the participants and their beneficiaries, and defray reasonable expenses of administering the retirement systems;
- with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes; *[Duty of Prudence]*
- by diversifying the investments of the retirement systems to minimize the risk of large losses, unless it is clearly not prudent to diversify under the circumstances;
- according to a good faith interpretation of the law governing the retirement systems;
- according to a good faith interpretation of the documents and instruments governing the retirement systems, if they comply with this Article."

Montgomery County Employee Retirement Plans
101 Monroe Street, 15th Floor • Rockville, Maryland 20850
240.777.8220 Fax 301.279.1424

The Duty of Loyalty and Duty of Prudence in the Montgomery County Code derive from the Employees' Retirement Income Security Act (ERISA), which governs private retirement plans and which public pension plans often use as their fiduciary standards. The Department of Labor has repeatedly interpreted the Duty of Loyalty to prohibit fiduciaries "from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives." The Department of Labor has also repeatedly stated that the Duty of Prudence prohibits investment decisions from being influenced by non-economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments.

Advocacy groups have targeted many nations, as well as individual companies, for divestment. The County Attorney's Office has advised us that under the Montgomery County Code, the Board does not have the authority to make investment decisions for moral, social, or political reasons (Duty of Loyalty) and must make investments based on economic criteria (Duty of Prudence). In making investment decisions, the Board may consider non-economic criteria only if the resulting investments are equal to or superior to investments based solely on economic criteria. The Board believes it may not be able to meet this test.

The Board is concerned about implementing an investment policy that uses non-economic criteria because it could have the following effects:

- An increase in the County contribution and in the unfunded liability (currently at $700 million) for the ERS due to:
  - potentially lower returns and greater risk. A 0.1% decrease in the ERS' investment return equates to an estimated annual increase of $2,700,000 in the required County contribution;
  - potential termination by existing investment managers who are unwilling to accept portfolio restrictions and the potential inability to hire future managers who share this view;
  - additional costs for monitoring systems and staff resources associated with identifying and certifying companies targeted by a divestment effort and researching and conducting due diligence for any replacement securities or fund; and
  - higher transaction costs from selling or disposing of securities.
- Difficulty in establishing policies that determine whether divestment of a specific security and replacement with another security is prudent.
- Potential creation of fiduciary liability for trustees and potential reluctance to serve on the Board.
- Potential restrictions on the mutual/commingled fund choices available to employees enrolled in the Retirement Savings Plan and the Deferred Compensation Plan, which could result in lower returns and less money available at retirement.

The Duty of Loyalty and the Duty of Prudence in County law require the Board to implement investment policies for the County's three retirement plans that serve the thousands of employees, retirees, and beneficiaries who rely on them. If the Council and the Executive decide to amend the Code to impose investment restrictions with respect to any nation or company, the Board will modify its investment policies accordingly.

Sincerely,

Kelda J.C. Simpson
Chair

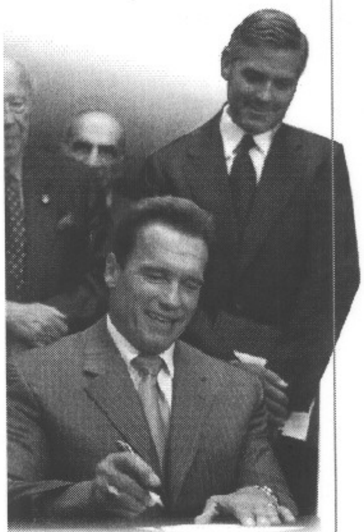
cc: Board of Investment Trustees

SUDAN DIVESTMENT
TASK FORCE
A project of the Genocide Intervention Network

PHONE (202) 481-8220
FAX (800) 991-2024
E-MAIL info@SudanDivestment.org
WEB SITE www.SudanDivestment.org

"The divestment movement [helps] draw international attention to the appalling situation in Darfur while pressuring the foreign companies working with the murderous Sudanese government to pull out. That could be a catalyst for change in Africa's worst killing zone."

— The Los Angeles Times Editorial Board, March 2006



California Governor Arnold Schwarzenegger is joined by actor George Clooney and former Secretary of State George Shultz at a public signing for California's targeted Sudan divestment bill.

WHAT IS THE SUDAN DIVESTMENT TASK FORCE?

As the coordinating entity for the Sudan divestment movement, the Sudan Divestment Task Force supports Sudan divestment campaigns at the university, city state, national, and asset manager levels. The Sudan Divestment Task Force also provides company research and corporate engagement assistance to hundreds of fiduciaries worldwide, representing more than $1.5 trillion in total assets.

TARGETED DIVESTMENT: AN INNOVATIVE APPROACH TO STOPPING GENOCIDE

The new millennium's first genocide rages unabated into its fifth year in the Darfur region of Sudan. For the first time in history, genocide has been declared while the atrocities are *ongoing*. Although humanitarian groups have courageously assisted the millions of displaced in Darfur, international action has been shamefully underwhelming. The magnitude of the crimes in Darfur combined with the failure of the international community to stem these horrors has given states, cities, and other institutions around the world impetus to act. Divestment is one of the sharpest tools investors have for influencing Sudan's behavior.

The Sudan Divestment Task Force, a project of the Genocide Intervention Network, has developed a uniquely targeted approach to divestment, focusing only on the most egregiously offending companies in Sudan. Since the ultimate intent of Sudanese divestment is to protect the victims of genocide, it is important to tailor divestment so as to have maximal impact on the government of Sudan's behavior, while minimizing potential harm to innocent Sudanese. Divestment should therefore be targeted to those companies that have a business relationship with the government or government-created project, impart minimal benefit to the country's underprivileged, have expressed no significant corporate governance policy regarding the current situation in Darfur *and* have proven unresponsive to attempts at shareholder engagement. Targeted divestment explicitly excludes the vast majority of companies in Sudan, including those tied to the agricultural sector, distribution of general consumer goods, promotion of non-oil-related infrastructure development in underprivileged regions of the country, and those involved in the provision of goods and services intended to relieve human suffering or to promote welfare, health, education, and religious and spiritual activities.

A GROWING INTERNATIONAL MOVEMENT

Since the movement began in April 2005, more than 50 universities, 15 states, and 5 cities have placed restrictions on their Sudan-linked investments. Active campaigns are now underway in eight countries. In addition to providing research on Sudan-linked companies to fiduciaries around the world, the Sudan Divestment Task Force also works with the asset management community to create Sudan-free investment opportunities.

The Sudan Divestment Task Force has received media coverage on both an international and local level. Featured stories, editorials, and op-eds have appeared in major media outlets, including the New York Times, BBC, Los Angeles Times, Washington Post, Wall Street Journal, Boston Globe, Christian Science Monitor, Financial Times, International Herald Tribune, Forbes Magazine, Bloomberg, CNN, and the San Francisco Chronicle.

HOUSE BILL 1336

K4 (7lr3071)

ENROLLED BILL

— Appropriations / Budget and Taxation —

Introduced by **Delegates Branch, Anderson, Benson, Burns, Cane, Davis, Gaines, Glenn, Griffith, Harrison, Holmes, Howard, Jones, Kirk, Levi, Morhaim, Nathan–Pulliam, Oaks, Pena–Melnyk, Proctor, Rice, Stukes, Tarrant, Taylor, F. Turner, Vaughn, and Walker**

Read and Examined by Proofreaders:

____
Proofreader.

____
Proofreader.

Sealed with the Great Seal and presented to the Governor, for his approval this

______ day of _____________ at ______________________ o'clock, _______M.

____
Speaker.

CHAPTER _____

AN ACT concerning

2007 Darfur Protection Act – Divestiture from the Republic of Sudan

FOR the purpose of requiring the Board of Trustees of the State Retirement and Pension System to review certain investment holdings; requiring the Board of Trustees to encourage certain companies to take certain actions; requiring the Board of Trustees to provide written notice to certain companies; authorizing the Board of Trustees to take divestment action with regard to certain investments; prohibiting the Board of Trustees from acquiring certain

EXPLANATION: CAPITALS INDICATE MATTER ADDED TO EXISTING LAW.
[Brackets] indicate matter deleted from existing law.
Underlining indicates amendments to bill.
~~Strike out~~ indicates matter stricken from the bill by amendment or deleted from the law by amendment.
Italics indicate opposite chamber / conference committee amendments.

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securities; requiring the Board of Trustees to take certain issues into account prior to taking certain actions; requiring the Board of Trustees to publish certain reports containing certain information on or before a certain date; defining certain terms; providing for the termination of this Act under certain circumstances; and generally relating to the divestment of investments from the Republic of Sudan.

BY adding to
Article – State Personnel and Pensions
Section 21–123.1
Annotated Code of Maryland
(2004 Replacement Volume and 2006 Supplement)

Preamble

WHEREAS, On September 9, 2004, Secretary of State Colin L. Powell told the United States Senate Foreign Relations Committee that "genocide has occurred and may still be occurring in Darfur" and "the Government of Sudan and the Janjaweed bear responsibility"; and

WHEREAS, On September 21, 2004, addressing the United Nations General Assembly, President George W. Bush affirmed the Secretary of State's finding and stated, "at this hour, the world is witnessing terrible suffering and horrible crimes in the Darfur region of Sudan, crimes my government has concluded are genocide"; and

WHEREAS, On September 25, 2006, the United States Congress reaffirmed that "the genocide unfolding in the Darfur region of Sudan is characterized by acts of terrorism and atrocities directed against civilians, including mass murder, rape, and sexual violence committed by the Janjaweed and associated militias with the complicity and support of the National Congress Party–led faction of the Government of Sudan"; and

WHEREAS, On September 26, 2006, the United States Congress stated that "an estimated 300,000 to 400,000 people have been killed by the Government of Sudan and its Janjaweed allies since the Darfur crisis began in 2003, more than 2,000,000 people have been displaced from their homes, and more than 250,000 people from Darfur remain in refugee camps in Chad"; and

WHEREAS, The Darfur crisis represents the first time the United States Government has labeled ongoing atrocities a genocide; and

WHEREAS, The federal government has imposed sanctions against the Government of Sudan since 1997, that are monitored through the United States Treasury Department's Office of Foreign Assets Control (OFAC); and

WHEREAS, According to a former chair of the United States Securities and Exchange Commission (SEC), "the fact that a foreign company is doing material business with a country, government, or entity on OFAC's sanctions list is, in the SEC staff's view, substantially likely to be significant to a reasonable investor's decision about whether to invest in that company"; and

WHEREAS, In response to the financial risk posed by investments in companies doing business with a terrorist–sponsoring state, the SEC established its Office of Global Security Risk to provide for enhanced disclosure of material information regarding such companies; and

WHEREAS, Despite significant pressure from the United States government, the Republic of Sudan fails to take necessary actions to disassociate itself from its ties to terrorism and genocide; and

WHEREAS, Companies supporting such ties with terrorism and genocide present further material risk to remaining investors of these companies; and

WHEREAS, It is a fundamental responsibility of the State to decide where, how, and by whom financial resources in its control should be invested, taking into account numerous pertinent factors; and

WHEREAS, It is the prerogative and desire of the State, in respect to investment resources in its control and to the extent reasonable, with due consideration for, among other things, return on investment, on behalf of itself and its investment beneficiaries, not to participate in an ownership or capital–providing capacity with entities that provide significant practical support for genocide, including certain international companies presently doing business in Sudan; and

WHEREAS, It is the judgment of the General Assembly that this Act should remain in effect only insofar as it continues to be consistent with, and does not unduly interfere with, the foreign policy of the United States as determined by the federal government; and

WHEREAS, It is the judgment of the General Assembly that divestment of public funds from certain companies is a measure that should be employed sparingly and judiciously – a United States Congressional and Presidential declaration of genocide satisfying this high threshold; now, therefore,

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

Article – State Personnel and Pensions

21–123.1.

(A) (1) IN THIS SECTION THE FOLLOWING WORDS HAVE THE MEANINGS INDICATED.

(2) "COMPANY" MEANS ANY CORPORATION, UTILITY, PARTNERSHIP, JOINT VENTURE, FRANCHISOR, FRANCHISEE, TRUST, ENTITY, INVESTMENT VEHICLE, FINANCIAL INSTITUTION, OR ITS WHOLLY OWNED SUBSIDIARY;

(3) (I) "ACTIVELY MANAGED SEPARATE ACCOUNTS" MEANS THE ACCOUNTS OF THE SEVERAL SYSTEMS THAT ARE ACTIVELY MANAGED AT THE DIRECTION OF THE BOARD OF TRUSTEES AND HELD IN SEPARATE ACCOUNTS.

(II) "ACTIVELY MANAGED SEPARATE ACCOUNTS" DOES NOT MEAN INDEXED FUNDS, PRIVATE EQUITY FUNDS, REAL ESTATE FUNDS, ~~AND~~ *OR* OTHER COMMINGLED OR PASSIVELY MANAGED FUNDS.

(4) "DIVESTMENT ACTION" MEANS SELLING, REDEEMING, TRANSFERRING, EXCHANGING, OR OTHERWISE DISPOSING OF OR REFRAINING FROM FURTHER INVESTMENT IN CERTAIN INVESTMENTS.

(5) "DOING BUSINESS IN SUDAN" MEANS MAINTAINING EQUIPMENT, FACILITIES, PERSONNEL, OR OTHER APPARATUS OF BUSINESS OR COMMERCE IN SUDAN, INCLUDING OWNERSHIP OF REAL OR PERSONAL PROPERTY IN SUDAN, OR ENGAGING IN ANY BUSINESS ACTIVITY WITH THE GOVERNMENT OF SUDAN.

(6) "ELIGIBLE ACCOUNTS" MEANS ACTIVELY MANAGED SEPARATE ACCOUNTS CONTAINING FUNDS OF THE SEVERAL SYSTEMS.

(7) "INVESTMENT" MEANS THE COMMITMENT OF FUNDS OR OTHER ASSETS TO A COMPANY, INCLUDING:

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(I) THE OWNERSHIP OR CONTROL OF A SHARE OR INTEREST IN THE COMPANY; OR

(II) THE OWNERSHIP OR CONTROL OF A BOND OR OTHER DEBT INSTRUMENT BY A COMPANY.

(8) (I) "SUDAN" MEANS THE GOVERNMENT IN KHARTOUM, SUDAN, THAT IS LED BY THE NATIONAL CONGRESS PARTY (FORMERLY KNOWN AS THE NATIONAL ISLAMIC FRONT) OR ANY SUCCESSOR GOVERNMENT FORMED ON OR AFTER OCTOBER 13, 2006, INCLUDING THE COALITION NATIONAL UNITY GOVERNMENT AGREED ON IN THE COMPREHENSIVE PEACE AGREEMENT FOR SUDAN.

(II) "SUDAN" DOES NOT MEAN THE REGIONAL GOVERNMENT OF SOUTHERN SUDAN.

(B) THE BOARD OF TRUSTEES SHALL REVIEW THE INVESTMENT HOLDINGS IN ELIGIBLE ACCOUNTS FOR THE PURPOSE OF DETERMINING THE EXTENT TO WHICH FUNDS IN ELIGIBLE ACCOUNTS ARE INVESTED IN COMPANIES DOING BUSINESS IN SUDAN.

(C) CONSISTENT WITH THE FIDUCIARY DUTIES OF THE BOARD OF TRUSTEES UNDER SUBTITLE 2 OF THIS TITLE, AND THE PROVISIONS OF SUBSECTION (D) OF THIS SECTION, THE BOARD OF TRUSTEES:

(1) SHALL ENCOURAGE COMPANIES IN WHICH ELIGIBLE ACCOUNTS ARE INVESTED AND THAT ARE DOING BUSINESS IN SUDAN TO ACT RESPONSIBLY AND AVOID ACTIONS THAT PROMOTE OR OTHERWISE ENABLE HUMAN RIGHTS VIOLATIONS IN SUDAN;

(2) MAY TAKE DIVESTMENT ACTION IN ELIGIBLE ACCOUNTS WITH REGARD TO INVESTMENTS:

(I) IN ANY COMPANY DOING BUSINESS IN SUDAN; OR

(II) IN ANY SECURITY OR INSTRUMENT ISSUED BY SUDAN; AND

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(3) MAY NOT MAKE ANY NEW INVESTMENTS FROM NET NEW FUNDS IN AN ELIGIBLE ACCOUNT IN ANY COMPANY THAT IS DOING BUSINESS IN SUDAN.

(D) IN DETERMINING WHETHER TO TAKE DIVESTMENT ACTION UNDER SUBSECTION (C) OF THIS SECTION WITH REGARD TO THE INVESTMENT OF FUNDS IN ELIGIBLE ACCOUNTS IN A COMPANY DOING BUSINESS IN SUDAN, THE BOARD OF TRUSTEES SHALL CONSIDER THE FOLLOWING:

(1) REVENUES PAID BY A COMPANY DIRECTLY TO THE GOVERNMENT OF SUDAN;

(2) WHETHER A COMPANY SUPPLIES INFRASTRUCTURE OR RESOURCES USED BY THE GOVERNMENT OF SUDAN TO IMPLEMENT ITS POLICIES OF GENOCIDE IN DARFUR OR OTHER REGIONS OF SUDAN;

(3) WHETHER A COMPANY KNOWINGLY OBSTRUCTS LAWFUL INQUIRIES INTO ITS OPERATIONS AND INVESTMENTS IN SUDAN;

(4) WHETHER A COMPANY ATTEMPTS TO CIRCUMVENT ANY APPLICABLE SANCTIONS OF THE UNITED STATES;

(5) THE EXTENT OF ANY HUMANITARIAN ACTIVITIES UNDERTAKEN BY A COMPANY IN SUDAN;

(6) WHETHER A COMPANY IS ENGAGED SOLELY IN THE PROVISION OF GOODS AND SERVICES INTENDED TO RELIEVE HUMAN SUFFERING, OR TO PROMOTE WELFARE, HEALTH, EDUCATION, OR RELIGIOUS OR SPIRITUAL ACTIVITIES;

(7) WHETHER A COMPANY IS AUTHORIZED BY THE FEDERAL GOVERNMENT OF THE UNITED STATES TO DO BUSINESS IN SUDAN;

(8) EVIDENCE THAT A COMPANY HAS ENGAGED THE GOVERNMENT OF SUDAN TO CEASE ITS ABUSES IN DARFUR OR OTHER REGIONS IN SUDAN;

(9) WHETHER A COMPANY IS ENGAGED SOLELY IN JOURNALISTIC ACTIVITIES; AND

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(10) ANY OTHER FACTOR THAT THE BOARD OF TRUSTEES DEEMS PRUDENT.

(E) IF THE BOARD OF TRUSTEES TAKES DIVESTMENT ACTION UNDER SUBSECTION (C) OF THIS SECTION, WITH RESPECT TO INVESTMENTS IN A COMPANY, THE BOARD OF TRUSTEES SHALL PROVIDE THE COMPANY WITH WRITTEN NOTICE OF ITS DECISION AND REASONS FOR THE DECISION.

(F) ON OR BEFORE OCTOBER 1 OF EACH YEAR, AND EVERY 3 MONTHS THEREAFTER, THE BOARD OF TRUSTEES SHALL SUBMIT A REPORT IN ACCORDANCE WITH § 2–1246 OF THE STATE GOVERNMENT ARTICLE TO THE SENATE BUDGET AND TAXATION COMMITTEE, THE HOUSE APPROPRIATIONS COMMITTEE, AND THE JOINT COMMITTEE ON PENSIONS THAT PROVIDES:

(1) A SUMMARY OF CORRESPONDENCE WITH COMPANIES ENGAGED BY THE BOARD OF TRUSTEES UNDER THIS SECTION;

(2) ALL DIVESTMENT ACTIONS TAKEN BY THE BOARD OF TRUSTEES IN ACCORDANCE WITH THIS SECTION;

(3) A LIST OF COMPANIES DOING BUSINESS IN SUDAN WHICH THE BOARD OF TRUSTEES HAS DETERMINED TO BE INELIGIBLE FOR INVESTMENTS OF NET NEW FUNDS UNDER SUBSECTION (C)(3) OF THIS SECTION; AND

(4) OTHER DEVELOPMENTS RELEVANT TO INVESTMENT IN COMPANIES DOING BUSINESS IN SUDAN.

SECTION 2. AND BE IT FURTHER ENACTED, That if the President of the United States rescinds or repeals Executive Order 13067, with no further action required by the General Assembly, this Act shall be abrogated and of no further force and effect. Within 5 working days of the President of the United States rescinding or repealing Executive Order 13067, the Board of Trustees for the State Retirement and Pension System shall notify the Department of Legislative Services in writing of the rescission or repeal at 90 State Circle, Annapolis, Maryland 21401.

SECTION 3. AND BE IT FURTHER ENACTED, That, subject to the provisions of Section 2 of this Act, this Act shall take effect July 1, 2007.

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STATE RETIREMENT
and PENSION SYSTEM
of MARYLAND

STATE RETIREMENT AGENCY
120 East Baltimore Street
Baltimore, MD 21202
Tel: 410-625-5555
1-800-492-5909
TDD/TTY 410-625-5535
www.sra.state.md.us

September 27, 2007

Honorable Ulysses Currie
Chair, Budget and Taxation
Miller Senate Office Building
3 West Wing
11 Bladen Street
Annapolis, MD 21401

Honorable Rona E. Kramer
Co-Chair, Joint Committee on Pensions
Miller Senate Office Building
Room 214
11 Bladen Street
Annapolis, MD 21401

Honorable Norman H. Conway
Chair, Appropriations Committee
House Office Building
Room 121
6 Bladen Street
Annapolis, MD 21401

Honorable Melony Ghee Griffith
Co-Chair, Joint Committee on Pensions
House Office Building
Room 412
6 Bladen Street
Annapolis, MD 21401

Dear Chairmen Currie, Kramer, Conway and Griffith,

As required by the 2007 Darfur Protection Act – Divestiture from the Republic of Sudan, I am submitting the first quarterly report required under the Act. This report, prepared by the State Retirement and Pension System, describes the actions taken by the System as a result of the Act, which is being codified at SPP § 21-123.1 of the Annotated Code of Maryland.

The Act requires that the Board of Trustees review its investments in companies that conduct business in the Republic of Sudan in order to determine if those investments should continue. The Act describes criteria the Board should consider in making their decisions, and actions the Board should take to implement those decisions. In addition, the Act requires that the Board submit a report describing its compliance with the Act to the Senate Budget and Taxation and House Appropriations Committees as well as the Joint Committee on Pensions quarterly.

This report includes the following:

i. A summary of correspondence with companies engaged by the Board of Trustees;

ii. All divestment actions taken by the Board of Trustees;

iii. A list of companies doing business in Sudan which the Board of Trustees has determined to be ineligible for investments of net new funds;

iv. Other developments relevant to investments in companies doing business in Sudan.

Please contact me should you have any concerns or questions regarding this report.

Sincerely,

R. Dean Kenderdine
Executive Secretary

Attachment

1. A summary of correspondence with companies engaged by the Board of Trustees;

Fall 2006/Winter 2007

The System hired Institutional Shareholder Services (ISS) to provide a monthly list of companies doing business in Sudan. The System received its first list in November, 2006. Engagement letters were initially sent to eleven companies on the list that were believed to be owned in one or more of the portfolios managed for the System by its external managers. The letters requested that the companies provide information regarding their activities in the Republic of Sudan and their plans for staying in Sudan. The letters inquired whether the company would maintain the current level of activity, reduce it or withdraw from the country. Seven companies responded with information about their involvement in Sudan as well as their codes of ethics and social responsibility policies.

The eleven companies engaged were Alcatel-Lucent, Alstom, AMEC LLC, Ericsson Inc., Lukoil OAO, Marathon Oil Corp, Schlumberger Ltd., OAO Tatneft, Terex Corporation, Total SA, and Wartsila Oyj.

Spring 2007

The System sent follow-up letters to the four companies who did not respond to the first letters and to six additional companies. The System also conducted follow up electronic communications with the investor relations departments at some of the companies. The six companies that received their first engagement letter from the System were BAE Systems PLC, BP PLC, Petrochina Company Limited, Rolls-Royce, Royal Dutch Shell PLC, and Siemens AG.

Summer 2007/Fall 2007

The Act took effect July 1, 2007. As a result of the definition of "doing business in Sudan" in Section (A)(5) of the Act, several companies were removed from the ISS list, and several were added. Effective July 1, 2007, no new investment in any company on the ISS list may be made in any Eligible Account. The System has recently sent letters to the six companies on the restricted list that it owned in eligible accounts as of June 30, 2007. These letters have asked the companies to respond to the criteria described in Section (D) of the Save Darfur Act.

The six companies engaged are Alcatel-Lucent, Alstom, Petrofac Ltd., Petrolium Nasional, Schlumberger Ltd. and Total SA.

2. All divestment actions taken by the Board of Trustees

In October 2006, the System hired Institutional Shareholder Services (ISS) to provide a list of companies doing business in Sudan monthly.

In February, 2007, the System informed its managers of Eligible Accounts of the Sudan related legislation and sent them the January 31, 2007, ISS list of companies doing business in Sudan. This was to increase their awareness of the pending legislation and to facilitate their planning.

In April, 2007, the System sent the managers of Eligible Accounts a copy of the Save Darfur Act of 2007. The managers were informed that they would not be required to sell their holdings in the identified companies immediately, but,as of July 1, 2007, they would be restricted from investing any additional funds in any of the companies on the list.

As of June 30, 2007, ISS customized the Maryland Restricted List to meet the definition of "doing business in Sudan" in Section (A)(5) of the Save Darfur Act. At that time, the System owned seven of the 41 companies identified by ISS in Eligible Accounts. The System sent the customized list from ISS to all the managers of Eligible Accounts. The managers will receive the list every month.

In August, the Board of Trustees considered the divestment of the investment in one company, Schlumberger Ltd., an oil field service company domiciled in the Netherland Antilles that is currently operating in the Sudan. In light of (1) recent reports that Schlumberger is making strides to increase its humanitarian response to the situation in Darfur, and (2) the fact that the Save Darfur Task Force (an international watchdog organization described in response to Question 4) has modified its listing of Schlumberger from "Highest Offenders" to "Ongoing Engagement", the Board decided to defer the consideration of divesting the System's assets from Schlumberger Ltd. for up to 90 days.

3. The following companies doing business in Sudan were on the ISS list as of June 30, 2007, and are ineligible for investments of net new funds.

Company Name	Owned in Eligible Account?
Alcatel Lucent	Yes
Alstom	Yes
Aref Investment Group	
Bharat Electronics Ltd.	
Bharat Heavy Electicals Ltd.	
Bollore	
CHC Helicopter Corp.	
China Petroleum & Chemical Corp. (Sinopec)	
CNPC Hong Kong Ltd.	
Dong Feng Motor Group Ltd.	
Electricity Generating Public Company (EGCO)	
Harbin Power Equipment Co.	
ICSA (India) Ltd.	
Indian Oil Corporation	
Kejuruteraan Samudra Timur Bhd	
Kencana Petroleum Bhd	
La Mancha Resources Inc.	
Lundin Petroleum A	
Mangalore Refinery and Petrochemicals Ltd.	
Marathon Oil Corp ‡	
MISC Bhd	
MMC Corporation Bhd	
Muhibbah Engineering (M) Berhad	
Nam Fatt Co. Bhd	
Oil & Natural Gas Corporation Ltd. (ONGC)-	
PECD Bhd	

Company Name	Owned in Eligible Account?
Petrochina Company Limited	
Petrofac Ltd.	Yes
Petroliam Nasional (Petronas)	Yes
PSL Ltd.	
Reliance Industries Ltd.	
Sarawak Enterprise Corp. Bhd	
Schlumberger Ltd.	Yes
Scomi Group Bhd	
Societe des Participations du Commissariat a l'Energie Atomique (Areva)	
Sudan Telecom Co. Ltd. (Sudatel)	
Sumatec Resources B	
Terex Corp.	Yes*
Total SA	Yes
Wartsila Oyj	

Note: Terex Corp was removed from the ISS list effective 8/31/2007; it does not conduct business in Sudan.

4. Other developments.

A. In addition to the research it receives from ISS, independent research conducted by staff, and information received from companies as a result of the System's engagement efforts, staff is obtaining more in-depth research from the Sudan Divestment Task Force.

The Task Force, a project of the Genocide Intervention Network, is actively involved in dozens of Sudan divestment campaigns around the world at the university, asset manager, city, state, and national levels.

The Task Force has pro bono legal support from the law firm of Cooley Godward Kronish LLP and analytical support from the Calvert Group, Ltd.

The Task Force provides company research and corporate engagement assistance to hundreds of fiduciaries worldwide.

The Task Force focuses its engagement and divestment efforts on the most egregiously offending companies in Sudan.

The Task Force believes that this approach, which they call "targeted divestment", helps to maximize impact on the Sudanese government, while minimizing potential harm to both innocent Sudanese civilians and investment returns.

B. At the request of Senator Verna Jones, a member of the Agency's staff participated in a panel session regarding the development and implementation of the 2007 Darfur Protection Act at the NCSL's annual education conference in Boston in August 2007.

KLD Large Cap Sudan Free Social Index

KLD INDEXES

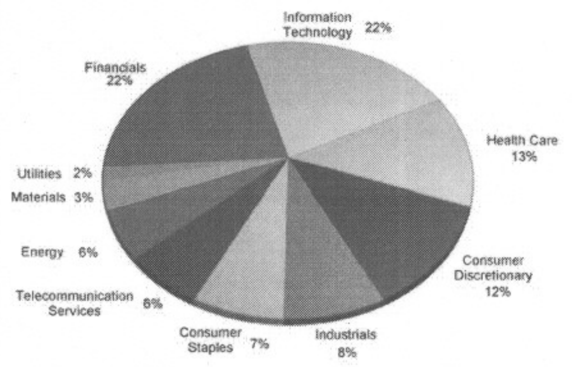
All data as of September 30, 2007

Index Characteristics	LCSFSI	Russell 1000
Price/Earnings	34.97	29.09
Price/Book	5.03	4.83
Dividend Yield	1.64	1.71
Beta	1.00	1.00
R-Square	0.98	1.00
Sharpe Ratio	0.63	0.86
Standard Deviation	2.58	2.55
Tracking Error	0.38	0.00

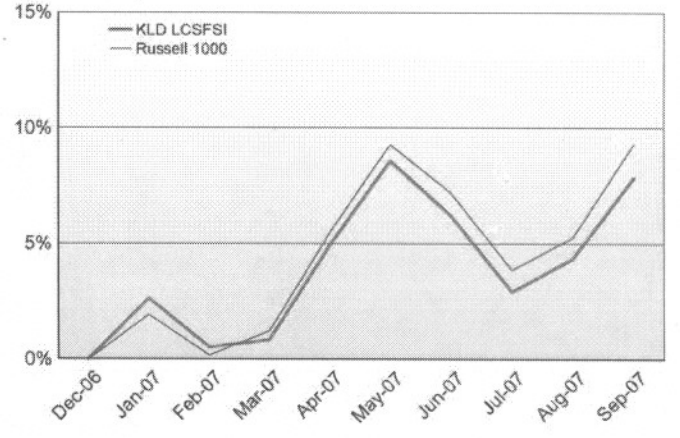
Market Capitalization ($ Millions)	LCSFSI	Russell 1000
Total	9,574,493	16,223,499
Average	13,485	16,047
Median	5,262	5,564
Largest	276,976	513,362
Smallest	472	472

Top 10 Holdings
AT&T Inc.
Microsoft Corp.
Bank of America Corp.
Procter & Gamble Co.
Cisco Systems, Inc.
Johnson & Johnson
International Business Machines Corp.
Intel Corp.
Hewlett-Packard Co.
Apple Inc.

Sector Breakdown (GICS Method)



Cumulative Return (Inception – September 30, 2007)



Index Performance (%)	Month	3rd Quarter	YTD	One Year	Three Year*	Five Year*	Ten Year*	Since 1/1/07 Inception*
LCSFSI	3.33	1.54	7.85	N/A	N/A	N/A	N/A	7.85
Russell 1000	3.82	1.98	9.30	16.90	13.77	15.98	6.86	9.30

*Annualized Returns

Sources: Bloomberg, FactSet Research Systems and Russell Indexes.

KLD LARGE CAP SUDAN FREE SOCIAL INDEX

Ex-Sudan Portfolio Performance Comparison

*For Periods Ending June 30, 2007 **

	ONE YEAR	THREE YEAR	FIVE YEAR
US EQUITY			
Custom S & P 500 x-Sudan	20.35%	11.52%	10.65%
S&P 500 Index (Published)	20.61%	11.68%	10.75%
Variance vs. Index	-0.26%	-0.16%	-0.10%
NON-US EQUITY (Developed Markets)			
Custom MSCI ACW x-US/xSudan	30.03%	24.78%	19.75%
MSCI ACW x-US Index (Gross)	30.14%	25.02%	19.85%
Variance vs. Index	-0.11%	-0.24%	-0.10%
NON-US EQUITY (Emerging Markets)			
Custom MSCI Emerging x-Sudan	45.13%	38.18%	30.23%
MSCI Emerging Index (Gross)	45.41%	38.66%	30.65%
Variance vs Index (Gross)	-0. 28%	-0.48%	-0.42%

*Source: Wilshire Consulting

Bloomberg.com

Berkshire Shareholders Defeat PetroChina Resolution (Update7)

By Josh P. Hamilton and Jesse Westbrook

More Photos/Details

May 5 (Bloomberg) -- Berkshire Hathaway Inc. shareholders voted by a 53-to-1 margin against an investor proposal calling on the firm to divest a $3.3 billion stake in PetroChina Co. because it's controlled by a company that does business in Sudan.

China National Petroleum Corp., PetroChina's parent, holds oil reserves and pipelines in Sudan, where the government has been accused of supporting genocide. At final count, 830,598 votes were cast against the resolution and 15,740 for it, the company said today at Berkshire's annual meeting in Omaha, Nebraska.

``We have no disagreement with what PetroChina is doing,'' said Berkshire Chairman and Chief Executive Officer Warren Buffett. ``If there was a disagreement it would be with what the Chinese government is doing.''

China, which controls China National, joined with Russia, Qatar and South Africa to block a U.S. effort at the United Nations to increase pressure on Sudan to accept more than 20,000 peacekeeping troops in Darfur. Sudan has accepted about 3,000 UN soldiers and police to support the 7,000 African Union troops trying to protect civilians in Darfur.

Buffett said he agrees ``100 percent'' that Darfur violence is wrong. He has said PetroChina has no influence over China National. Divestment would only help the Sudanese government get control of the Chinese assets inexpensively, Berkshire says on its website.

Buffett's decision hasn't swayed activists who say putting the world's third-richest man on the spot will draw attention to their campaign to cut the flow of oil revenue to Sudan's government. Buffett, 76, often scolds corporate America for putting profits ahead of ethics. The billionaire in June pledged the bulk of his fortune to the Bill and Melinda Gates Foundation, a gift valued at the time at about $37 billion.

`An Extremely Ethical Man'

``As an exemplar of business ethics and integrity, your divestiture would send a message to China,'' said Judith Porter, a semi-retired college professor, who introduced the resolution.

Conflict broke out in 2003 when rebels seeking a larger share of Sudan's political power and oil wealth attacked the government. At least 200,000 civilians have since died in Darfur, in the western region of Sudan, according to the United Nations and Human Rights Watch.

The government, dominated by Muslim Arabs, has been accused by the UN and the U.S. of supplying money, weapons and vehicles to mainly Arab militias known as the Janjaweed that have targeted African villages in rebel held areas. The U.S. Congress said the killings amounted to genocide.

`Never Again'

``Genocide should never again happen,'' said Judith Porter. ``The world was silent when my grandparents were murdered by the Nazis,'' then during genocide in Cambodia, Bosnia, Rwanda, she said. ``How many times must we say `never again?'''

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Buffett said he sees ``no effect whatsoever in Berkshire Hathaway trying to tell the Chinese government how to conduct business.'' It's ``understandable'' China is looking worldwide for energy, said Buffett. The U.S. Congress ``snubbed'' the Chinese in 2005, when it opposed an attempt by Chinese company Cnooc Ltd. to acquire U.S. oil producer Unocal Corp, Buffett said. Chevron Corp., based in San Ramon, California, later acquired Unocal.

Berkshire owns 1.3 percent of PetroChina and is the largest shareholder after China National, which owns 90 percent of the stock. China National Petroleum led development of the first oil field in Sudan and is the largest foreign oil company operating in the country.

Supporters of the resolution say PetroChina and China National have some of the top managers.

``They look different, but they are actually two sides of the same corporation,'' said Gerald Porter, Judith's husband.

Lopsided Vote

The lopsided vote margin reflects votes by large shareholders, including Buffett, who owns about a third of Berkshire's stock, Porter said. The tally includes both Class B shares and more highly valued Class A shares, which carry larger voting weight. Buffett said that without his votes, the ratio would have been 25-to-1.

``I think if you look at the number of people who voted for the resolution, it'd be a much higher percentage,'' Gerald Porter said.

Berkshire paid $488 million for its PetroChina stake, according to regulatory filings. It soared sevenfold in value through Dec. 31.

Buffett has built Berkshire over the past four decades from a failing textile maker into a holding company with businesses ranging from ice cream to utilities to insurance and a market value of $168 billion.

PWBA Office of Regulations and Interpretations

Advisory Opinion

May 28, 1998

William M. Tartikoff
Senior Vice President and General Counsel
Calvert Group Ltd.
4550 Montgomery Avenue
Bethesda, Maryland 20814

98-04A
ERISA SEC.
404(c)

Dear Mr. Tartikoff:

This is in response to your request, on behalf of the Calvert Group, Ltd., for an advisory opinion concerning the application of the fiduciary responsibility rules of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Specifically, you have requested the Department's views concerning whether a plan fiduciary's selection of a "socially- responsible fund" as a plan investment or a designated investment alternative for a section 404(c) plan would, in itself, violate the general fiduciary duties and responsibilities of sections 403(c) and 404(a)(1) of ERISA.

A "socially-responsible fund", as described in your letter, is a mutual fund registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and, as such, is subject to the Act and the rules and regulations thereunder. You represent that such funds are designed to achieve a defined investment goal through the use of traditional investment processes and, in addition, by investing in enterprises that the fund managers believe make a significant contribution to society through their products and services and the way they do business. In this regard, you indicate that potential investments are first screened for their financial soundness and, after the financial screening is complete, the investments are evaluated according to the particular fund's social criteria. Evaluation of social criteria may include considering such facts as the effect of a company's products and services on the natural environment, whether the company being invested in is managed with participation of its employees, whether the company negotiates fairly with its workers and provides a good working environment, and whether the company fosters a commitment to human goals such as creativity and productivity. Managers of "socially-responsible" funds also may engage in pro-active dialogues with the management of portfolio holdings on social issues or submit proxy proposals. These policies and criteria are described in the fund's prospectus.

You represent that the social criteria vary from fund to fund, and that, as with any mutual fund, performance is evaluated using standard market indices. The relevant benchmarks are described in the annual reports of the funds sent to shareholders, thereby allowing the shareholders to evaluate fund performance against the same measures used for funds that do not employ social screens.

Sections 403(c) and 404(a)(1) of ERISA require, among other things, that a plan fiduciary act prudently, solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries These fiduciary standards apply to the selection and monitoring of both plan investments and designated investment alternatives in a participant directed

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individual account plan.[1]

The Department has expressed the view that the fiduciary standards of sections 403 and 404 do not preclude consideration of collateral benefits, such as those offered by a "socially- responsible" fund, in a fiduciary's evaluation of a particular investment opportunity. However, the existence of such collateral benefits may be decisive only if the fiduciary determines that the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks. In this regard, the Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to participants and beneficiaries, as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives. In other words, in deciding whether and to what extent to invest in a particular investment, or to make a particular fund available as a designated investment alternative, a fiduciary must ordinarily consider only factors relating to the interests of plan participants and beneficiaries in their retirement income. A decision to make an investment, or to designate an investment alternative, may not be influenced by non-economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments.[2]

In discharging investment duties, it is the view of the Department that fiduciaries must, among other things, consider the role the particular investment or investment course of action in the plan's investment portfolio, taking into account such factors as diversification, liquidity, and risk/return characteristics. Because every investment necessarily causes a plan to forgo other investment opportunities, fiduciaries also must consider expected return on alternative investments with similar risks available to the plan. [3]

Your letter requests guidance concerning the application of the above standards to a plan fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or as a designated investment alternative for an ERISA section 404(c) plan.

With regard to your request, it is the view of the Department that the same standards set forth in sections 403 and 404 of ERISA governing a fiduciary's investment decisions, discussed above, apply to a fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or, in the case of an ERISA section 404(c) plan, a designated investment alternative under the plan. Accordingly, if the above requirements are met, the selection of a "socially- responsible" mutual fund as either a plan investment or a designated investment alternative for an ERISA section 404(c) plan would not, in itself, be inconsistent with the fiduciary standards set forth in sections 403(c) and 404(a)(1) of ERISA.

In issuing this opinion, the Department is not expressing any view as to the appropriateness of any particular fund or investment alternative. Whether a particular fund or investment alternative satisfies the requirements set forth in sections 403 and 404 of ERISA is an inherently factual question, and the Department generally will not issue opinions on such questions. The appropriate plan fiduciaries must make this determination, based on all the facts and circumstances of the individual situation.

This letter constitutes an advisory opinion under ERISA Procedure 76-1, 41 Fed. Reg. 36281 (1976). Accordingly, this letter is issued subject to the provisions of that procedure, including section 10 thereof, relating to the effect of advisory opinions.

Sincerely,

Robert J. Doyle, Director
Office of Regulations and

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Interpretations

[1]In connection with the publication of the final rule regarding participant directed individual account plans, the Department emphasized that the act of designating investment alternatives in an ERISA section 404(c) plan is a fiduciary function to which the limitation on liability provided by section 404(c) is not applicable. 57 Fed. Reg. 46922 (October 13, 1992).

[2]*See*, letters from the Department of Labor to Theodore Groom (January 16, 1981); to William Chadwick (January 21, 1982); Ralph Katz (March 15, 1982 and October 23, 1985); James S. Ray (July 8, 1988); to Stuart Cohen (May 14, 1993); and Advisory Opinions Nos. 85- 36A and 88-16A. *Also see* 29 CFR §2509.94-1.

[3] *See* 29 CFR §§2550.404a-1 and 2509.94-1.

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SUDAN DIVESTMENT
TASK FORCE
A project of the Genocide Intervention Network

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EFFICACY OF TARGETED DIVESTMENT: AT A GLANCE

The government of Sudan has been historically responsive to economic pressure.

US sanctions declared in 1997 caused the Sudanese government to drop its support for terror and cooperate with the US on counter-terrorism. The emerging Sudan divestment movement has already caught the attention of the Sudanese government, which has spent considerable time and energy attacking the campaign, even going so far as to purchase a six page ad for more than $1 million in the New York Times to counteract the divestment movement. Unlike isolated countries that tend to shrug off sanctions, the Sudanese government is desperately trying to attract foreign investment. Threats to these efforts are taken very seriously by Sudan.

Divestment makes genocide costly.

Under current political and diplomatic pressure the Sudanese government incurs virtually no cost for continuing its genocide in Darfur, beyond further damage to its image in the West. Divestment, however, forces the Sudanese government to pay a price for its refusal to restore peace and security to Darfur.

Widespread divestment causes share price depreciation.

While the effect of divestment on offending companies' share prices thus far remains unclear, the divestment movement is spreading with enormous speed, both in the US and internationally. It is only a matter of time before enough assets have been divested to actually make a substantial impact on share prices. There is precedent for share price depreciation vis-à-vis a previous Sudan divestment campaign—Talisman Energy's share price was estimated to have dropped roughly a third on account of the divestment campaign against it.

Foreign direct investment enables the Sudanese government to carry out genocide in Darfur.

Recent increases in foreign direct investment in Sudan, particularly in the oil industry, have disproportionately benefited Sudan's military and elite. Since oil was first extracted in 1999, Sudan's military budget has more than doubled. It is estimated that 70-80% of oil revenue is now funneled into Sudan's military.

The Sudanese government is paying attention to the divestment movement.

The Sudanese embassy authored a press release and an op-ed condemning divestment, and the Sudanese ambassador actually spoke by phone with activists in an attempt to discourage divestment. The Sudanese government even took out a six-page ad in the New York Times this past March extolling Sudan as a peaceful country worthy of foreign direct investment.

Companies in Sudan are already responding to shareholder pressure.

CHC Helicopter Corporation, the world's largest provider of helicopter services to the global offshore oil and gas industry and previously a highly scrutinized company in Sudan, recently ceased all business operations in Sudan for the indefinite future after substantial levels of inquiry from a range of concerned investors. Another firm operating in Sudan and an S&P 500 company, Schlumberger, which provides oil-field services to the major oil consortiums in Sudan, has committed to reinforcing its existing outreach programs by implementing substantial humanitarian programs to reach marginalized populations in the country.

Also this year, Rolls Royce PLC, which sells oil-engineering equipment, announced its decision to leave Sudan citing "increasing international humanitarian concerns about the situation in Darfur." Additionally, Swiss power giant ABB announced its decision to suspend all non-humanitarian operations in Sudan--a decision in which divestment played a partial role. Shortly thereafter, one of Germany's largest companies, Siemens, pledged to pull out of the country, also citing the pressure created by divestment as a factor.

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Some American firms exempted from US sanctions, including Xerox and 3M, have decided to curtail all non-humanitarian operations in the country. Companies have also begun to go so far as to list the divestment movement as a potential concern on SEC filings. Finally, in a clear sign of concern, companies tied to Sudan have spent increasing amounts on political contributions to Congressional leaders who are supporting Sudan divestment legislation.

Sudan divestment keeps the media focused on Darfur.

Divestment continues to keep Darfur in the public eye and sends a clear message to both the Federal government and the international community that the crisis warrants attention. Additionally, the divestment campaign highlights the role that foreign corporations and governments play in sustaining the genocidal policies of the government of Sudan. Coverage for divestment has appeared in the New York Times, Wall Street Journal, Washington Post, International Herald Tribune, LA Times, BBC, Financial Times, NPR, Christian Science Monitor, and many other media outlets. See www.sudandivestment.org/inthenews.asp for a representative listing.

Targeted Divestment: Supported by Foreign Policy and Financial Experts

Prominent foreign policy experts and think tanks which do not classically support blanket sanctions, including experts from the International Crisis Group, Harvard University, the Heritage Foundation, and former UN Envoy to Sudan, Jan Pronk, have all endorsed targeted sanctions, including divestment, on the Sudanese regime calling it a critical tool for influencing the behavior of the Sudanese government and bringing long-term peace and security to the region. In March 2007, the *Associated Press* reported that opposition leaders in Sudan have also expressed support for targeted sanctions on the Khartoum government. Finally, a number of Sudan experts from around the globe have pointed to targeted divestment as a financially prudent strategy for helping to stop genocide in Darfur.

International Crisis Group
"The [targeted Sudan divestment] campaign should be encouraged, including by naming and shaming companies, and copied in other countries."

Roberta Cohen – Senior Advisor, The Brookings Institution
"In the view of some analysts, divestment campaigns may prove more effective than sanctions. Rolls Royce's withdrawal from Sudan this past year reportedly surprised the government and affected the import of needed machine parts. The Sudanese government has publicly urged an end to divestment actions, underscoring the potential sting of their impact."

UN Human Rights Council
"…the General Assembly should call upon all UN institutions and offices to abstain from entering into business transactions with [foreign companies that have an adverse impact on the situation of human rights in Darfur]."

Joseph Stiglitz - Nobel Prize Winner and Trustee of Amherst College
"The government does not have a heavy development agenda--it's not as though the government is busy building schools in Darfur. It's a pretty clear case of this money being used against the government's own people."

Alfred Taban, editor of the independent newspaper, the Khartoum Monitor
"[Sudanese officials are] very worried about such sanctions. They get a lot of money from these companies."

A Coalition 15 Former European, Canadian, and US Foreign Ministers
"If by the end [of 2006], Mr Bashir still refuses or, more likely, continues pretending to agree one day and saying no the next, he should pay a stiff price. That price should include…measures to target revenue from Sudan's oil sales."

For a full report on the efficacy of targeted divestment and complete references, visit
www.sudandivestment.org/position.asp.

CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

AUGUST 2007, NUMBER 7-12

SHOULD PUBLIC PLANS ENGAGE IN SOCIAL INVESTING?

BY ALICIA H. MUNNELL*

Introduction

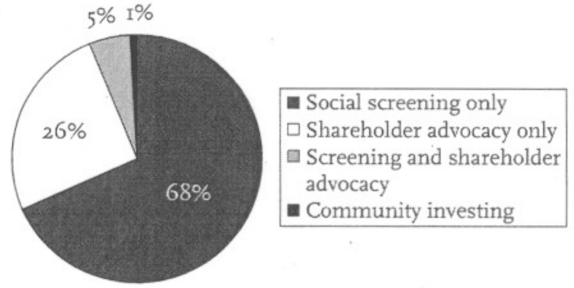
Social investing is a movement that advocates incorporating social and environmental considerations, as well as financial factors, when making investment decisions. The most recent incarnation of this movement is the initiative by state legislatures to force public pension funds to sell their holdings of companies doing business in Sudan. The effort to divest Sudan-linked stocks began in 2004 after the U.S. government characterized the killing and displacement in Darfur province as genocide.[1] Riding on the coattails of the success of the Sudan effort, state legislatures have now targeted Iran, with a goal of "terror-free" investing. The emotional appeal of such actions is powerful. Over 2 million civilians have been displaced and more than 200,000 slaughtered in Darfur since 2003.[2] And Iran refuses to back away from its pursuit of nuclear weapons.[3] But strong arguments also exist against using public pension plans to accomplish foreign policy goals.

This *brief* explores the current world of social investing, the recent efforts regarding the Sudan and Iran, the likely impact of social investing on the target firms, and the reasons why such activity may be inappropriate for public pension plans.

What Is Social Investing? How Much? Who's Doing It?

Social investing takes three primary forms: 1) screening (either excluding "bad" companies or including "good" companies); 2) shareholder advocacy; and 3) community investing. The Social Investment Forum (SIF), a trade group of social investors, reports that at the end of 2005, in terms of assets under management, screening is by far the most prevalent approach (see Figure 1). Significantly less is involved in shareholder advocacy, and community investing activity is tiny.

FIGURE 1. SOCIAL INVESTING IN THE UNITED STATES BY TYPE OF STRATEGY, 2005



Source: Social Investment Forum (2006).

* Alicia H. Munnell is the Director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Jerilyn Libby served as the major research assistant on this project; Dan Muldoon also provided able assistance. John Langbein and Alan Marcus provided valuable comments.

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Table 1. Assets in Socially Screened Portfolios, 1999-2005 (Billions)

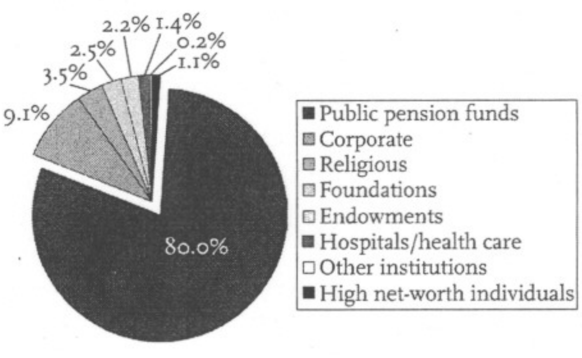
Year	Mutual funds	Separate accounts	Total
1995	$12	$150	$162
1997	96	433	529
1999	154	1,343	1,497
2001	140	1,870	2,010
2003	151	1,992	2,143
2005	179	1,506	1,685

Source: Center for Retirement Research at Boston College (2006).

The Social Investment Forum reports that as of the end of 2005, mutual funds with social screens held $179 billion and that socially screened "separate accounts," which are managed for individuals and institutional clients, held $1,506 billion (see Table 1). The SIF calculates that these totals amount to 9.4 percent of all public and private assets under management.

The bulk of the money in separate accounts (80 percent) is the assets of public pension funds (see Figure 2). And screening is pervasive among public funds. The SIF numbers suggest that, in 2005, $1.2 trillion of public pension fund assets were screened by some criteria. These screened assets accounted for 45 percent of total state and local pension holdings in that year.[4]

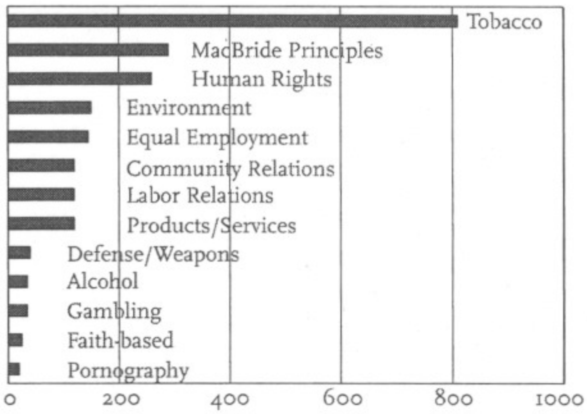
Figure 2. Socially Screened Investor Assets, 2005



Source: Social Investment Forum (2006).

The screens vary by the nature of the customer. As of 2005, by far the most popular approach for mutual funds was a negative screen for tobacco; alcohol came in second; gambling third.[5] But the pattern for institutional separate accounts, which is dominated by public plans, is quite different. For these accounts, the MacBride Principles (relating to fair hiring in Northern Ireland), Human Rights, the Environment, and Equal Employment Opportunity ranked among the top social concerns (see Figure 3).

Figure 3. Social Screening by Institutional Investors, 2005 (Billions)



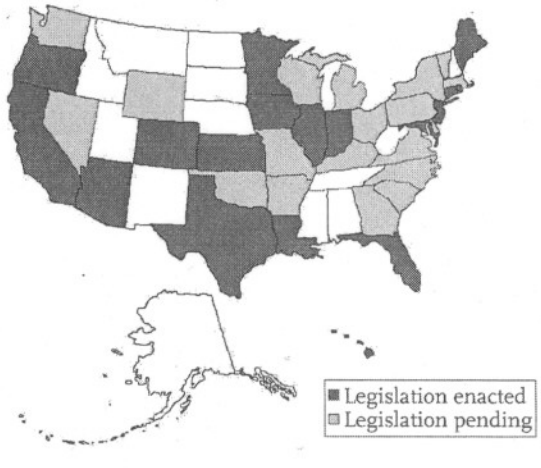
Source: Social Investment Forum (2006).

Note that almost none of the screened money is held in private sector defined benefit pension funds.[6] These private plans are covered by the Employee Retirement Income Security Act (ERISA), and right from the beginning the Department of Labor has stringently enforced ERISA's duties of loyalty and prudence.[7] In 1980, the chief administrator of the Department of Labor's pension section published an influential article that warned that the exclusion of investment options would be very hard to defend under ERISA's prudence and loyalty tests.[8] And a 1994 Interpretive Bulletin reminded fiduciaries that they are prohibited from subordinating the interests of participants and beneficiaries ... to unrelated objectives."[9] Thus, ERISA fiduciary law has effectively constrained social investing in private sector defined benefit plans.[10] Social investing is a public pension fund phenomenon.

Recent Developments – Sudan and Now Iran

During 2005, and therefore not reflected in Figure 3, state legislatures in Arizona, Illinois, Louisiana, New Jersey, and Oregon passed legislation related to companies with operations in Sudan.[11] Since then some states have branched out to include Iran. And Missouri has taken the lead in initiating an entirely "terror-free" investment policy. American companies have been barred for some time from doing business in either Sudan or with states considered sponsors of terrorism according to the U.S. State Department (Cuba, Iran, North Korea, Sudan and Syria).[12] But in a world of global investing, U.S. investors can have a link to Sudan or "terror states" through foreign stock holdings. Such foreign holdings would be most affected by the recent state legislation.

FIGURE 4. STATES THAT HAVE ENACTED OR ARE CONSIDERING SUDAN DIVESTMENT LEGISLATION, 2007



Sources: National Conference of State Legislatures (2007); Office of Missouri State Treasurer (2005); Sudan Divestment Task Force (2007); State of Arizona (2005), State of Arkansas (2007); and State of Louisiana (2005 and 2007).

Sudan

As of August 2007, eighteen states have passed laws regarding divestment of state pension and other funds from Sudan (see Figure 4).[13] Divesting is not easy, however. State and local pension funds tend to invest in global indices, so the exercise involves identifying the companies with links to Sudan and then constructing a Sudan-free index that mimics established benchmarks.

Generally, the states have asked their money managers to figure out which stocks have a Sudan link. Money managers, in turn, have left it to the social investing firms, such as KLD Research and Analytics, Institutional Shareholders Services, and the Conflict Securities Advisory Group to identify companies involved in Sudan. KLD originally said that 124 companies were on its Sudan list, including eight American companies.[14] The social investing firms refuse to make the names public, however, since that is how they earn their money.[15] And apparently, the lists are not definitive. Some companies appeared on the original KLD list even though they were not actually doing business in Sudan. And for at least one, 3M, its involvement was the result of a U.N. purchase of Scotchshield Ultra Safety and Security Film to protect embassy and mission windows from explosions, a transaction that was authorized by the federal government.[16]

The Sudan Divestment Task Force (2007) publishes a more tightly targeted list, recommending the divestment of only 28 companies. These are companies that 1) do business with the Sudanese government; 2) provide little benefit to the disadvantaged of Sudan; and 3) have not developed policies to prevent their business activities from inadvertently contributing to the government's genocide capability.

Fund managers take the Sudan-link list and attempt to construct "Sudan Free" funds that mimic popular benchmarks. This step is also a challenge. According to the chief investment strategist at Northern Trust, whose fund tracks the Morgan Stanley Capital International Europe Australasia Far East index (MSCI EAFE) index, constructing a "Sudan-free" index will require divesting 25 companies or 9 percent of assets.[17]

Despite the challenges involved, public funds have moved $2.2 billion away from Sudan-linked companies between 2005 and 2007.[18]

Iran

More recently, "terror-free" investment has been picking up steam. The primary targets are companies doing business in Iran.[19] As noted above, U.S. companies have long been barred from operating in Iran, but more than 200 multinationals have investments there, from Royal Dutch Shell and France's telecommunications-equipment company Alcatel to Sweden's electronics company Ericsson.[20]

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On June 8, 2007, Florida's governor signed a Sudan and Iran Divestiture bill into law. Florida follows other states with regard to Sudan, but is the first to enact divestiture legislation for companies doing business with Iran.[21] Louisiana, which had passed "terror-free investing" legislation in 2005, permits — but does not require — divestment. Arizona, which also passed legislation in 2005, only requires the public retirement system to disclose investments in terror-linked companies. In Illinois, the state Senate passed an Iran divestment bill on June 14, 2007 which would compel the state's five retirement systems to divest Iran-connected companies in energy and other natural resources.[22] California, Georgia, Kansas, Michigan, Missouri, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, and Texas are also considering adopting Iran-free investing (see Figure 5).[23]

If some of the bills are passed in their broadest form, institutions may be forced to sell $18 billion in investments.[24] Selling all Iran-related securities would add substantial risk to an indexed international equity portfolio. State Street Global Advisors (SSgA), Boston, has had preliminary conversations with clients about Iran divestments. SSgA estimates that if all companies with ties to Iran were removed from Morgan Stanley's EAFE index and replaced with similar performing companies, it would introduce a tracking error of up to 200 basis points, compared to the tracking error on a typical index of between five and 10 basis points.[25]

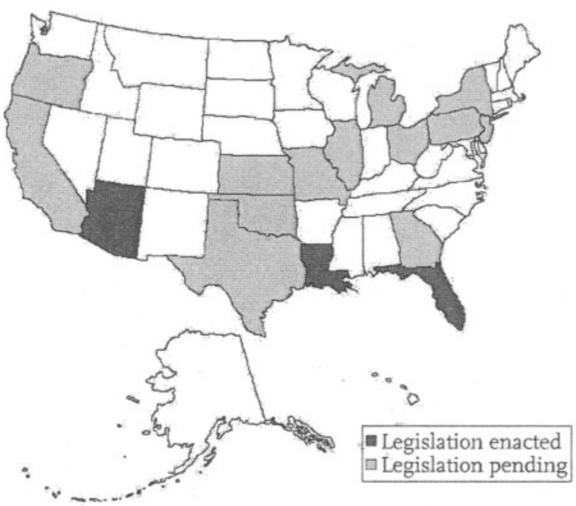
Some state legislatures, however, are limiting the scope of divestiture to energy-related stocks, arguing that such action is likely to be most effective in curbing terrorist activities. Narrowing the scope greatly reduces the number of stocks and amount that would have to be sold.[26]

Iran is a more politically complicated issue than Sudan. Sometimes promoters of "divest Iran" suggest that the effort is aimed at Al Qaeda.[27] But Al Qaeda is an enemy without a state and therefore difficult to target. In addition, the U.S. government is not enthusiastic about the effort, because it is working on its own initiative with allies to curtail business transactions tied to nuclear activities and support for terrorism. Treasury and State Department officials have expressed concern that broad-based divestiture could cause a backlash if allies feel that a wide range of companies is under attack.[28]

Despite the complexities involved with Iran, some states have gone even further and are pursuing "terror-free" investing, which extends the scope of the boycott to all the countries on the U.S. State Department's State Sponsors of Terrorism list, which includes Cuba, Syria, and North Korea. Missouri has been at the forefront of this movement. The State Treasurer claims that at least 500 big foreign companies and multinationals do at least some business in countries identified as sponsoring terrorism.[29] The Treasurer's goal is to have all Missouri's investments "terror–free," although the state legislature has not yet passed divestiture legislation for the state pension funds.[30] Anti-terrorism bills have been enacted in Arizona, Florida, and Louisiana.

Given the substantial amount of social investing by public pension funds, it is useful to consider the likely impact of such activity on the targets of the social screen and the likely impact on the pension funds themselves.

Figure 5. States that Have Enacted or Are Considering Iran Divestment Legislation, 2007



Sources: National Conference of State Legislatures (2007); Office of Missouri State Treasurer (2005); State of Arizona (2005), and State of Louisiana (2005 and 2007).

The Economics of Social Investing

The academic literature suggests that social screens are likely to have very little impact on the target company and that the impact on the pension fund depends on the scale of the screen.

Impact on Targeted Company

The SIF Report suggests that social investing will have a financial impact — that investors are putting their money to work in ways that will build "a better, more just, and sustainable economy." The academic literature on the stock market, however, suggests the opposite. And a comprehensive survey on the effect of the South African boycott — the largest and most visible social action — documents virtually no effect, suggesting the real world mirrors the textbook model.

Injecting politics into pension policy is problematic.

According to standard finance theory, the price of any stock equals the present discounted value of expected future cash flows. Thus, the stock of a particular firm has a lot of close substitutes, which makes the demand curve for a particular stock, in economists' terms, almost perfectly elastic.[31] That is, even a big change in quantity demanded will lead to only a small change in price. And any significant deviation from the fundamental price would represent a profitable trading opportunity that market participants would quickly exploit and thus correct.[32] In other words, boycotting tobacco stocks or international companies doing business in Sudan or Iran may result in a temporary fall in the stock price, but as long as some buyers remain they can swoop in, purchase the stock, and make money. And the buyers are out there. The "Vice Fund," which was established in September 2002, specializes in only four sectors — alcohol, tobacco, arms, and gambling, and thus stands ready to buy the stocks screened out of standard portfolios.[33] Thus, the textbooks suggest that boycotting tobacco companies or international companies doing business in Iran is unlikely to have any impact on the price of their stocks.

A 1999 study took a comprehensive look at how equity prices responded to sanctions and pressures for firms to divest their holdings in South Africa.[34] The conclusion that emerges from a series of event studies is that the anti-apartheid shareholder and legislative boycotts had no negative effect on the valuation of banks or corporations with South African operations or on the South African financial markets. This is not to say that the boycott was not important politically, but merely that it did not impact financial markets. The study looks at pressure put on firms from both congressional action and divestiture by pension funds and universities.

The bulk of the congressional action occurred in 1985 and 1986, when the U.S. government passed legislation imposing trade embargoes, currency sanctions, and lending restrictions. Most importantly, the Comprehensive Anti-Apartheid Act of 1986 prohibited new private or public loans to South Africa other than for humanitarian purposes. To test the impact of this prohibition, the study identified ten important legislative events leading up to the 1986 Act and examined their impact on a portfolio of nine banks with South African loans. The results showed few significant effects on bank stock prices and where significant they were of the wrong sign.

Pension funds and universities also put pressure on corporations. Pension fund involvement in the South African issue began when a number of churches threatened to divest from banks doing business in South Africa. In 1977, the first iteration of the "Sullivan principles," which called for non-segregation of races and equal pay for equal work, was adopted in the hope that by adhering to these principles, companies could continue doing business in South Africa and at the same time promote non-discrimination policies.[35] But many felt that the Sullivan principles did not go far enough, so Reverend Sullivan called in 1987 for companies to withdraw completely from South Africa. Many funds began to divest themselves even of companies that had followed these principles.[36] The study looked at the effect of 16 pension fund divestments on a portfolio of firms with the highest exposure in South Africa. The results showed no evidence that the pension fund divestment announcements hurt firms with major South African operations.

In short, financial textbooks characterize the demand curves for individual stock as infinitely elastic, so the price of the stock of a targeted company is unlikely to be affected by a boycott so long as additional buyers remain to scoop up the profit opportunity. The fact that an effort as large as the boycott of firms doing business in South Africa had virtually no effect on stock prices suggests that the financial effect of social investing on target firms is roughly zero.

Impact on the Pension Fund

But does social investing affect the pension fund adversely? Modern portfolio theory states that investors should diversify their asset holdings over a variety of securities, so that the returns on all financial assets do not move in lockstep.[37] The question is how many securities are needed for the portfolio to be efficient? The answer is that an investor needs only 20-30 stocks to construct a fully diversified portfolio.[38] The small number of required stocks suggests that eliminating, say, tobacco, which accounts for about 1 percent of the market capitalization of the S&P 500, should leave enough securities to construct something very, very close to the market index. As the number excluded increases, it would become increasingly difficult to duplicate the market.[39]

In terms of evidence, considerable research has compared the risk-adjusted return of screened portfolios to the return of unscreened portfolios. Most of the studies cover the period since the mid-1980s. Overall, the results show that the differences in risk-adjusted returns between the screened portfolios and unscreened portfolios are negligible and in most cases zero.[40] A few studies have focused on the effects of divestiture of tobacco stocks in the 1990s and show that the risk and returns for the S&P 500 with and without tobacco stocks were almost identical.[41]

State actions may conflict with federal foreign policy.

In addition to comparing the performance of screened portfolios to the S&P 500, several studies have examined the performance of social investment funds relative to the S&P 500. The Domini Social Index includes 400 U.S. companies that pass multiple and broad-based social screens, and the Calvert Social Index is a broad-based index including 659 companies. The majority of these studies show that socially screened funds have no significant effect on risk-adjusted returns.[42]

In contrast, the evidence from the early days of the South Africa divestiture suggested that screening out stocks meant large losses. For example, in the 1970s, Princeton University reported that the stocks that had been excluded because of South Africa ties outperformed other holdings by 3 percent.[43] As time passed and researchers undertook more comprehensive studies, the conclusions shifted. For example, one study examined the performance of a South-Africa free portfolio compared to an unscreened NYSE portfolio for the period 1960-1983 and found that, after adjusting for risk, the portfolio excluding South Africa companies actually performed better than the unscreened portfolio.[44] The positive results occurred because companies with South Africa ties were large and excluding these companies increased reliance on small-cap stocks, which performed better on a risk-adjusted basis during this period. During the late 1980s, the results were also mixed. On the one hand, a 1998 study analyzed data from the Surveys of State and Local Employees (PENDAT) from the early 1990s and found no significant effect on returns from restrictions on South Africa investments.[45] On the other hand, the S&P 500 including South Africa stocks performed slightly better than the index without the stocks, and one study of public pension plans found that South Africa restrictions had a negative effect on returns.[46] Thus, a large divestiture movement could have some negative effect on returns earned by public plans.

Another aspect that has received less attention is the administrative costs of social investing. It is possible that social investing is associated with higher fees and therefore has lower net returns because additional resources are required by fund managers to do the screening. The 2003 SIF Report concluded that socially responsible funds appear as competitive as other funds when it comes to administrative costs. However, others challenge this view by pointing out that some of the large-cap social index funds have above-average fees.[47] Moreover, in the case of Sudan and Iran, constructing new indices to match existing benchmarks involves substantial costs.

In short, theoretical models of portfolio choice imply that restricting the portfolio to socially responsible investments could have an effect on the rate of return by limiting the ability to diversify. Given the large number of stocks available, however, the cost — using traditional asset pricing models — is likely to be negligible. The bulk of the studies, which compare risk-adjusted returns for socially screened portfolios to those of unrestricted portfolios, supports this claim. Although a "terror-free" effort as large as the South African divestiture may have had some effect.[48] And administrative costs may be an important issue.

Public Plans Are Not Suited to Social Investing

In the late 1970s, some observers identified the large and rapidly growing funds in state and local pension plans as a mechanism for achieving socially and politically desirable objectives. The initial debate focused on attempts to exclude from pension portfolios companies with specific characteristics, such as those with almost totally nonunion workforces or investments in South Africa. The focus quickly shifted to undertaking pension investments that would foster social goals such as economic development and home ownership.[49] Advocates generally contended that the broader goals could be achieved without any loss of return.

Early reports, however, suggested that the targeting did involve sacrificing return. For example, a 1983 study of state-administered pension funds showed that many states had purchased publicly or privately insured mortgage-backed pass-through securities to increase homeownership in their state.[50] Analysis of the risk/return characteristics of these targeted mortgage investments revealed that 10 states either inadvertently or deliberately had sacrificed as much as 200 basis points to foster homeownership. Similarly, in 1992, Connecticut's state pension fund lost $25 million attempting to shore up Colt Industries. The firm went bankrupt two years after the fund bought a 47 percent interest in an attempt to protect Connecticut jobs.[51] In Kansas, the state pension fund lost between $100 and $200 million on defaulted loans from an in-state investment program that included a chain of video stores, a steel mill, and a failed savings and loan bank.[52] State and local pension funds were on a naïve and dangerous path.[53]

The losses in the 1980s and early 1990s were a sharp wake-up call to a number of public pension fund managers who appeared to believe that they could accomplish social goals without sacrificing returns. Over the last 20 years, the rhetoric associated with targeted investments has changed markedly. Public pension fund managers, sensitive to the potential for losses, go out of their way to make clear that they are no longer willing to sacrifice returns for social considerations; almost every definition of social investing includes a requirement that the investment produce a "market rate of return."

Divestment can be complicated, costly, and ineffective.

In the recent debate regarding Sudan and Iran, trustees of public plans have spoken out opposing such initiatives. Administrators at California's large public pension funds — CalPERS and CalSTERS — oppose the California bills requiring divestiture. A CalPERS spokesman said that determining which companies have dealings with Iran would be a struggle: "We don't necessarily have the resources or the expertise."[54] Similarly, the executive director of Massachusetts' Pension Reserves Investment Management Board, which invests public plan assets, said "You hire us to make you money, and when you restrict our ability to pick stocks, you likely restrict our ability to get returns."[55] Ohio's legislature initially considered following the Missouri model making investments "terror-free" by filtering out all stocks with links to North Korea, Syria, Sudan or Iran. The pension fund administrators argued that the measure would affect stocks of more than 170 companies and require the funds to sell more than $9 billion. Administrative costs would exceed $60 million.[56]

Moreover, legislative mandates for pension fund investing may have implications elsewhere in the state. For example, in the case of Ohio the "terror-free" investing bill would have roped in companies such as Honda, DaimlerChrsyler AG, Bridgestone Corporation, Siemens, and Thyssenkrupp AG, all of which had investments in Ohio.[57] The pension funds estimated these companies employed more than 45,000 workers. In response, the legislature narrowed the scope of the effort and decided to go after only those companies with more than $20 million in Iran's energy sector.[58]

Most importantly, three aspects of public pension funds make them particularly ill-suited vehicles for social investing.

First, the decision-makers and the stakeholders are not the same people. The decision-makers are either the fund board or the state legislature. The stakeholders are tomorrow's beneficiaries and/or taxpayers. If social investing produces losses either through higher administrative costs or lower returns, tomorrow's taxpayers will have to ante up or future retirees will receive lower benefits. The welfare of these future actors is not well represented in the decision-making process.

Second, whereas the investment practices of many large public funds are first rate, other boards are much less experienced. The boards of smaller funds often consist of between five and eleven people including mayors, treasurers, comptrollers, city councilors, union leaders, and citizens. The process is often conducted behind closed doors and subject to little public scrutiny. Moreover, many state and local plans are still run in-house and involve the selection of individual stocks rather than broad-based indices. A front page *New York Times* article reported that political money sometimes affects pension investment decisions. As a result, pension boards may overlook excessive fees or high rates of turnover, and they may approve inappropriate investments.[59] Introducing divestment requirements into such an environment is problematic.

The final issue is the slippery slope. This round of divestment began with Sudan and involved only a few stocks. It is quickly spreading to Iran, where the issues are even more complicated and the number of companies substantially greater. If "terror-free" investing gains momentum, what is going to stop the spread to, say, Saudi Arabia, original home of 15 of the 19 hijackers involved in the 9/11 terrorist attacks? At some point, the administrative costs of broad-based divestiture will balloon and excluding large numbers of companies will definitely hurt returns.

Conclusion

Everyone is horrified by genocide, and no one wants to support terror. Yet even those who sell socially responsible funds admit that the issue of divestiture is complex. "You have to ask yourself what your goal is with divestment. What's there if the government falls? Is there a government there that will take over and be better? If the companies that pull out provide money, goods, and services, is there an understanding that will make the people poorer in the short run?"[60] Yes, the regime changed in South Africa, but many South Africans say that it was the cultural boycott — particularly in sports — rather than the divestiture of companies with South-Africa-linked activities that resulted in the peaceful ascendance of Nelson Mandela as president.[61]

In addition to the issue of effectiveness, the fundamental question is where foreign policy should be made. Sudan does not raise as many issues in this regard as Iran. The State Department is working closely with foreign governments to get specific companies to stop selected activities, particularly in Iran's energy sector. Additionally, in more than one instance, federal courts have ruled that state legislation regarding social investment was unconstitutional on grounds that it overlapped with federal regulations.[62] Statements by officials at both Treasury and the State Department make clear their concern that a broad-based divestiture could disrupt the government's effort.

But even assuming that divestment is an effective mechanism to stop genocide and reduce terror risk and that state legislatures and pension fund boards are the right place to make foreign policy, the issue remains whether pension funds are an appropriate vehicle for implementing that policy. The answer seems unquestionably "no." The decision-makers are not the people who will bear the brunt of any losses; rather they will accrue to future beneficiaries and/or taxpayers. In many instances, the environment surrounding public pension fund investing is politically charged and encouraging public pension fund trustees to take "their eyes off the prize" of the maximum return for any given level of risk is asking for trouble. And finally, boycotting companies doing business with particular countries is a slippery slope — today Sudan and Iran, tomorrow Saudi Arabia.

Endnotes

1 Actually, as early as 2000, many college endowments and public pension funds, including CalPERS, did not participate in the initial public offering of PetroChina, because of its involvement in oil extraction in Sudan. See Fried (2006).

2 Amnesty International (2007) and Hagan and Pallioni (2006).

3 U.S. Department of Treasury (2007).

4 The Federal Reserve Flow of Funds reports total assets for state and local pension plans of $2,701.5 billion in 2005.

5 The majority of funds (64 percent) use 5 or more screens; the remainder are divided between those with a single screen (25 percent) and those with 2-4 screens (11 percent).

6 Multi-employer plans have made a few efforts to stimulate demand for union labor, especially in the construction trades. And some health care companies and hospitals screen for tobacco. But generally very little social investment has taken place. The Social Investing Forum (SIF), however, has reported that nearly 10 percent, or $137 billion, of screened assets are in corporate defined benefit plans. It was impossible for the author to ferret out where this money was. The only corporation mentioned by SIF was the Federal Home Loan and Mortgage Corporation (Freddie Mac). Since Freddie Mac invests most of its money in home mortgages, it is not clear how it is involved in social screening. In a personal communication, SIF's Joshua Humphreys said that there are other corporations that are not included on the list, but SIF refused to give out any additional names.

7 ERISA requires a fiduciary to act "solely in the interests of the [plan] participants and beneficiaries... for the exclusive purpose" of providing benefits to them. A fiduciary must also act "with the care, skill, prudence, and diligence" of the traditional "prudent man." See Langbein, Stabile, and Wolk (2006).

8 Lanoff (1980).

9 U.S Department of Labor (1994).

10 Some companies offer their employees one or more mutual fund options that pursue social investing criteria. Such an option does not raise any fiduciary concerns because the decision is left entirely to the participant.

11 The New Jersey legislation requires its pension funds to divest holdings in businesses that have equity stakes in the Sudan. A similar bill in Illinois, enacted in June 2005, provides that a fiduciary should not transact any business with a company doing business with Sudan, although in February 2007 the Federal District Court for the Northern District of Illinois ruled this act unconstitutional. Oregon also passed such a law for its public pension funds, while Louisiana legislation permits, but does not require, divestiture of investments linked to the Sudan.

12 U.S. Department of State (2007a). In 1997, President Clinton issued an executive order barring companies from conducting business in the Sudan; foreign businesses do not fall under that restriction.

13 For example, Texas legislation, signed into law on June 15, 2007, will require both the Teacher Retirement System and the Texas Employees Retirement System to ask affected companies to cease business in Sudan and to divest shares of unresponsive companies. The Hawaiian Employees' Retirement System was required to divest from Sudan-related investments when legislation went into effect July 1st. In Connecticut, legislation enables the Treasurer to divest state funds invested in companies doing business in Sudan or decide against further or future investments. Nineteen other states have pending divestment legislation or are taking other actions towards divestment. For example, the New York State Comptroller adopted a targeted Sudan divestment policy for the New York State Common Retirement Fund.

14 Fried (2006).

15 A KLD employee told us that KLD sells their compliance list to institutional money managers who are interested in social divestment and that it is not in the company's best interest to allow outside organizations to obtain their list in whole or in part. KLD also would not provide information about the American companies on the list. This information was obtained through a personal communication with KLD's Randy O'Neill.

16 Fried (2006). In a personal communication, 3M's Jacqueline Berry also confirmed the sale of the Security Film to the United Nations.

17 Fried (2006) and a personal communication with Northern Trust's Priya Khetarpal.

18 Pichardo (2007).

19 The U.S. House Financial Services Committee on May 23, 2007 passed legislation that would protect public pension funds and their money managers from litigation in response to Iranian divestiture.

20 King (2007).

21 The new law requires the State's Board of Administration to contact companies with business ties to Sudan and with energy ties in Iran, asking them to stop such activities; unresponsive companies would have to be divested 90 days after the communication. See Pensions and Investments (2007a).

22 *Pensions and Investments* (2007b).

23 The California legislation, which was proposed in January and as of July is still in committee in the state senate, would force two of the nation's largest pension funds — for the state's public employees and teachers, with combined holdings of $400 billion — to remove their money from any foreign company doing business with Iran. See Abdollah (2007).

24 Pichardo (2007).

25 See Pichardo (2007); and also confirmed by a personal communication with SSgA's Gary Conway. Also, according to Northern Trust Global Investments, companies doing business in Iran comprise about 25 percent of the MSCI EAFE index, compared to about 15 percent with ties to Sudan.

26 When narrowed, the number of companies involved declines from 100-125 to the 19-25 range. In California, for example, CalPERS would have to divest $8 billion if a bill introduced by Joel Anderson is passed. If narrowed to companies only with energy interests in Iran, the divestiture requirement drops to $2 billion. See Pichardo (2007).

27 LaFranchi (2007).

28 See U.S. Department of Treasury (2007); U.S. Department of State (2007b); and McKinley (2007).

29 Karmin (2007).

30 See Frick (2007).

31 For a summary of the literature on testing the extent to which the supply curve is elastic, see Munnell and Sundén (2005).

32 The caveat is, of course, that potential buyers must not think the sale (purchase) reflects a negative (positive) assessment of the firm's financial condition or business prospects that could affect future cash flows. If potential purchasers believe that the seller is disposing of the stock because he knows something adverse they do not, they will revise down their assessment of the stock's value, and the transaction will reduce the price of the stock.

33 Apparently the Vice Fund has grown at 20 percent annually since its inception, outpacing the S&P's growth of 16 percent. At first blush, these results appear to contradict the conclusion that screening has no impact, but the period under consideration is far too short for these numbers to have meaningful implications. See Authers (2007).

34 Teoh, Welch, and Wazzan (1999).

35 During the 1970s, as opposition against the apartheid government increased, social activists charged that companies investing in South Africa indirectly supported the government and its discrimination policies. In an initial effort to resolve the conflict, the Reverend Leon Sullivan in 1977 introduced a set of guidelines for companies doing business in South Africa, the so-called "Sullivan Principles." By 1987, 127 U.S. companies had signed on to the Sullivan principles (Auerbach, 1987).

36 For example, CalPERS divested itself of $9.5 billion worth of shares of companies holding a South African subsidiary. Pressure to divest and a worsening economic and political environment in South Africa led many companies (IBM, Exxon, Ford, GM and Chrysler) to sell their holdings. See Teoh, Welch, and Wazzan (1999).

37 An asset can be characterized by its expected return and the risk associated with that return, measured by the variance in returns. The risk of a specific asset can be broken down into two parts: risks that are unique to that stock (firm risk) and risks that stem from market-wide variations such as business cycle variation, inflation, and interest rate fluctuations

(market risk). When assets are combined in a portfolio, the return on the overall portfolio is given by the average return of the assets. And the risk associated with the portfolio is determined by the variance of the individual returns and the degree to which the individual returns vary together (covariance). Thus, by combining assets into a portfolio that have differing risk characteristics, an investor can create an efficient portfolio — a portfolio that is expected to achieve a given level of expected returns while minimizing risk.

38 Assume an investor plans to divide his money among *n* stocks selected from the entire market portfolio. The portfolio variance is given by:

$$\text{Portfolio variance} = 1/n * \text{average variance} + (1 - 1/n) * \text{average covariance}$$

As the number of securities in the portfolio increases, the contribution to total risk from the individual firm-specific risk decreases and the contribution from how the risks vary in relation to each other (covariance) increases. Thus, as the number of securities increases, the overall portfolio variance approaches the economy-wide risk, represented by the second term in the equation. With 2 stocks in the portfolio, half of the overall variance is due to firm specific risk and half to market risk. By the time a portfolio contains 10 securities, 90 percent of the portfolio's variance should be determined by the market risk. With a 20 stock portfolio, 95 percent of the variance should be determined by the overall market risk. See Brearley and Myers (1988).

39 Rudd (1981) and Grossman and Sharpe (1986) argue that the investor will not be able to exactly duplicate the market portfolio, because the screened portfolio will have relatively greater covariation in returns. Rudd also argued that social investing will introduce size and other biases into the portfolio, which will lead to a deterioration in long-run performance.

40 Guerard (1997); Hamilton, Jo, and Statman (1993); Statman (2000); Bauer, Koedijk, and Otten (2002); Dhrymes (1998); and Bello (2005). A similar result has been found for bond portfolios (D'Antonio, Johnsen and Hutton, 1997).

41 DiBartolomeo (2000). In the late 1980s and early 1990s, tobacco stocks performed slightly better than the S&P 500 but during the second half of the 1990s the tobacco stocks underperformed the S&P 500 on a risk-adjusted basis (Social Investment Forum, 1999; and Ferrari, 2000). However, the overall effect of divesting tobacco stocks should be small because they only account for about 1 percent of the S&P 500.

42 Kurtz and DiBartolomeo (1996); DiBartolomeo and Kurtz (1999); DiBartolomeo (1996); and Bello (2005). Some critics of these results contend that the comparable returns reflect the fact that the screened funds invest a higher proportion of their assets in small cap stocks. Small caps have out-performed large caps over the period 1995 to 2007 by more than 3 percentage points (10.9 percent versus 7.8 percent). The discrepancy since the trough in the market in 2002 has been even greater (20.0 percent versus 11.0 percent). Bello (2005) contends, however, that the sizes of the companies in the screened and unscreened portfolios are very similar.

43 Malkiel (1991).

44 Grossman and Sharpe (1986).

45 Munnell and Sundén (2001).

46 Romano (1993).

47 Hickey (2000).

48 A recent study (Karolyi, 2007) of terror-free investing concluded that there were no significant differences in risk or return of stock portfolios screened on the basis of their operations in countries designated as state sponsors of terrorism and the S&P 500. This study, however, focused exclusively on U.S. markets, where very few firms do business in terror-linked countries. The author notes that "Broadening the analysis to incorporate a global investment strategy may render different results and conclusions."

49 Two books were instrumental to broadening the social investing debate — Rifkin and Barber (1978) and Litvak (1981).

50 Munnell (1983).

51 Schwimmer (1992); and Langbein, Stabile, and Wolk (2006).

52 White (1991).

53 In their initial forays into economically targeted investments, public pension fund managers generally

did not appear to recognize the "Catch-22" nature of the exercise. For the most part, the goals of increasing in-state housing investment and maximizing returns are inconsistent in the United States' highly developed capital markets. Any housing investment that offers a competitive return at an appropriate level of risk, such as a GNMA, does not need special consideration by public pension plans nor would such consideration increase the long-run supply of mortgage loans. Investments by pension funds that would increase the supply of housing funds must by definition either produce lower returns or involve greater risk. Sophisticated advocates of targeted investments recognized the efficiency of the market for housing finance and argued that pension funds could make a contribution through innovative forms of housing finance. But that was not what was going on in 1983; the in-state mortgages purchased by public pension funds tended to be conventional fixed-rate 30-year mortgages. See Munnell (1983).

54 McKinley (2007) and also confirmed by a personal communication with CalPERS' Brad Pacheco.

55 Mishra (2006).

56 King (2007).

57 Ohio Retirement Study Council (2007).

58 King (2007).

59 Walsh (2004).

60 The comment is from Julie Gorte, director of social research at Calvert Investments (Fried, 2006).

61 Authers (2007).

62 Stern (2007).

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The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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The Center for Retirement Research thanks AARP, AIM Investments, CitiStreet, Fidelity Investments, John Hancock, Nationwide Mutual Insurance Company, Prudential Financial, Standard & Poor's, State Street, and TIAA-CREF Institute for support of this project.

The research reported herein was supported by the Center's Partnership Program. The findings and conclusions expressed are solely those of the author and do not represent the views or policy of the partners or the Center for Retirement Research at Boston College.

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Sudan Company Profiles

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A Report by
The Sudan Divestment Task Force

UPDATED October 4, 2007

Contributors to this rankings report include the Sudan Divestment Task Force research team, various fiduciaries that have engaged companies on this list, non-profit groups and think tanks with information on Sudan, and donated efforts by individuals who specialize in research on companies operating in states with weak governance, with a particular recognition to John Fawcett. All research has been confirmed by at least two individuals unless indicated. Analytical review of certain companies has been provided by Calvert.

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Critical Background Information

PLEASE READ

The *Sudan Company Rankings* report is intended to serve as a listing of all companies that the Sudan Divestment Task Force (SDTF) feels warrant extra scrutiny by investors on account of their business operations in Sudan. While there are over 500 companies with connections to Sudan that SDTF has reviewed, only the small subset contained in this document appear to warrant further investigation.

Please also note that not all companies in this document warrant divestment. Some are clear candidates for shareholder engagement (further details of where to draw the line between divestment and engagement appear below).

CRITERIA

In contrast to other models of divestment that advocate targeting all non-humanitarian business connections to Sudan, SDTF only places a company in this document if it generally:

1. Has a business relationship with the government, a government-created project, or companies affiliated with a government-created project; AND

2. Provides little benefit to the disadvantaged populations of Sudan; AND

3. Has not developed a substantial business-practice policy that acknowledges and deals with the fact that the company may be inadvertently contributing to the Sudanese government's genocidal capacity.

These general criteria are more specifically defined in SDTF's legislative model for targeted divestment:

www.sudandivestment.org/docs/task_force_targeted_divestment_model.pdf

And/or SDTF's sample Investment Policy Statement:

www.sudandivestment.org/docs/SDTF_Investment_Policy_Statement.pdf

Nearly all of the companies SDTF targets are in the oil, mineral extraction, power, or defense industries. SDTF developed these criteria because we strongly feel that, in general, economic investment in a country is critical for democratization and improved living standards. We are only interested in targeting irresponsible investments that support a government committing genocide. Limiting the scope of divestment to worst offenders also serves to minimize potential impact on fiduciaries.

CRITICAL CAVEATS

1. Please note that our rankings report is updated quarterly and while our list of companies has remained generally consistent, we ask that our organization be consulted for updates before any action pursuant to our report is taken (a small number of companies have moved off our list during the past year while others have moved on).

2. As detailed below, we provide recommendations as to which companies mentioned in this document are best suited for divestment and/or continued shareholder engagement. If you do plan to divest or take action, please keep us informed.

3. Besides this document, SDTF produces a *Sudan Company Profile* report that provides background information on each company in the list below, including, in certain cases, the specific "asks" SDTF has for the company. SDTF can also provide spreadsheets that contain additional investment information on the companies contained in our list (including as many CUSIP, SEDOL, and other identifiers as we could identify as well as alternative company names). We also have executive contacts and mailing addresses available for all companies contained in our list. Please contact us if you would like any of these items:

info@sudandivestment.org

4. Please do not circulate or post this report; it will soon become outdated and we prefer that interested parties request the *Sudan Company Rankings* report directly from SDTF so we can adequately inform them as to the context and purpose of our document.

5. We have developed, in conjunction with InvestedInterests.com, an online screening tool (for educational purposes only) that allows individuals to screen US-based mutual funds for exposure to companies that appear on our report. The tool is based on holdings of mutual funds from the previous financial quarter.

Please see:

http://www.sudandivestment.org/screener.asp

6. We have developed a partnership with Calvert regarding Sudan divestment that includes analytical support for this document. The details of the SDTF-Calvert partnership can be viewed at:

www.calvert.com/sudan

7. Not all companies that appear in this report are targets for divestment; some have demonstrated a willingness to change their corporate behavior in Sudan (indeed, some have already taken admirable action), and some companies have ahd very concerning past activity, but unknown current operations in Sudan. These companies are therefore strong candidates for continued shareholder engagement. Finally, there are several companies with highly problematic operations in Sudan but who presently have no known publicly-traded equity. These companies may nevertheless be "investible" through private placements, corporate bonds, or private equity funds. **Accordingly, SDTF has created three categories of companies below:**

- **Highest Offenders**
- **Ongoing Engagement**
- **No Publicly-Traded Equity**

The explanation for each category precedes the actual list. SDTF emphasizes that all companies, regardless of category, should be engaged before any divestment decision is made.

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Entity_name	SSB Cusip	SSB Sedol	SSB ISIN	Local Ticker	Local Cusip	Local Sedol	Local Isin
	Source: State Street			Source: ISS			
Alcatel-Lucent	'013904305	'2216593	US0139043055	ALU	13904305	2216593	US0139043055
	'597500909	'5975006	FR0000130007				
Alstom	'B0DJ8Q909	'B0DJ8Q5	FR0010220475	ALO	F0259M475	B0DJ8Q5	FR0010220475
AREF Investment Group Co				AIG	M1491S108	6131335	KW0EQ0200398
AviChina Industry & Technology Company Ltd				**2357**	**Y0485Q109**	**6707899**	**CN0005926851**
Bharat Electronics Ltd	'613971902	'6139715	INE263A01016	500049	Y0881Q117	6139715	INE263A01016
Bharat Heavy Electricals Ltd.	'612952903	'6129523	INE257A01018	BHEL IN	Y0882L117	6129523	INE257A01018
Bollore (Formerly Bollore Technologies)				VB	F10668113	4109419	FR0000125858
China Petroleum & Chemical Corp.	'629181900	'6291819	CN0005789556	SNP	16941R108	2639189	US16941R1086
CNPC Hong Kong Ltd.				135	G2237F100	6340078	BMG2237F1005
Dongfeng Motor Group Company Ltd					Y20968106	B0PH5N3	CN000A0HMV55
Electricity Generating Public Co Ltd				EGCOMP	Y22834108	6304632	TH0465010005
Harbin Power Equipment Co.				1133	Y30683109	6422761	CN0008935511
I.C.S.A (INDIA) LTD				531524	Y4084X119	6540629	INE306B01011
Indian Oil Corporation Ltd				IOC	Y3925Y112	6253767	INE242A01010
Kejuruteraan Samudra Timur BHD				SAMUDRA	Y4640L104	B0M9M97	MYL7185OO001
Kencana Petroleum Bhd				KENCANA	Y4599R102	B1L72X3	MYL5122OO006
La Mancha Resources Inc.					503548109	2584290	CA5035481095
Lundin Petroleum A	'718762909	'7187627	SE0000825820	LUPE	W64566107	7187627	SE0000825820
Mangalore Refinery & Petrochemicals Ltd.				500109	Y5763P137	6121530	INE103A01014
MISC Berhad (Formerly Malaysia International Shipp	'655803005	'6558031	MYF3816O1005	MISC	Y5625T103	6557997	MYL3816OO005
MMC Corporation Bhd (frmly Malaysia Mining Corp. B	'655664001	'6556648	MYL2194OO008	MMC	Y60574103	6556648	MYL2194OO008
Muhibbah Engineering (M) Berhad				MUHIBAH	Y6151L100	6609304	MYL5703OO003
Nam Fatt Corporation Berhad				NAF	Y6199H103	6621159	MYL4901OO004
Oil & Natural Gas Corporation Ltd.				500312	Y64606117	6139362	INE213A01011
PECD BHD				PECD	Y6784F108	B033B13	MYL5093OO009
Petrochina Company Limited				PTR	7.1646E+104	2568841	US71646E1001
Petrofac Ltd				PFC		B0H2K53	
Petronas Bhd	all securities						
PSL Ltd.				526801	Y7116B112	6707918	INE474B01017
Reliance Industries Ltd.	'609962907	'6099626	INE002A01018	500325	Y72596102	6099626	INE002A01018
Sarawak Energy Bhd (Formerly Sarawak Enterprise Corp. Bhd.)				2356K	Y7529H102	6286439	MYL2356OO003
Schlumberger Ltd.	'806857108	'2779201	AN8068571086	SLB	806857108	2779201	AN8068571086
Scomi Engineering				**SCOMIEN**	**Y7541G108**	**6098452**	**MYL7366OO007**
SCOMI GROUP BERHAD	'B00PKJ901	'B00PKJ3	MYL7158OO008		Y7677T106	B00PKJ3	MYL7158OO008
Sinopec Kantons				934	G8165U100	6162692	BMG8165U1009
Sinopec Shanghai Petrochemical				SHI	82935M109	2800059	US82935M1099

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Entity_name	SSB Cusip	SSB Sedol	SSB ISIN	Local Ticker	Local Cusip	Local Sedol	Local Isin
	Source: State Street			Source: ISS			
Societe des Participations du Commissariat a l'Energie Atomique (Areva)				CEI	F84742109	4174116	FR0004275832
Sudan Telecom Co. Ltd. (SUDATEL)				SDTL	V88273103	B17N1P0	SD000A0F5KV7
Total SA (Formerly Total Fina Elf S.A)	'B15C55900	'2898032	US89151E1091	TOT	8.9151E+113	2898032	US89151E1091
	'89151E109	'B15C557	FR0000120271				
	'B15CLJ902	'B15CLJ3	BE0005554259				
Videocon Industries Ltd.	'615003902	'6150039	INE341A01010		Y9369T113	6929820	INE703A01011
Wartsila Oyj (Formerly Metra Oy)	'452518905	'4525189	FI0009003727	WRTBV	X98155116	4525189	FI0009003727

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